EXHIBIT I

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In re:

SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiff-Applicant,

-vs- 08-01789 (SMB)

BERNARD L. MADOFF INVESTMENT SECURITIES, LLC,

Defendant.

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In re:

BERNARD L. MADOFF,

Debtor.

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*** CONFIDENTIAL ***
VIDEOTAPED DEPOSITION
OF
BERNARD L. MADOFF
(Taken by the Customers)
Butner, North Carolina
December 20, 2016

Reported by: Lisa A. DeGroat, RPR
Notary Public

A P P E A R A N C E S

For the Customers:

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The Videographer:
Robert Collier

CONFIDENTIAL VIDEOTAPED DEPOSITION OF BERNARD L. MADOFF, taken by the Customers, at the Federal Correctional Institution, Butner Medium I, Old NC Highway 75, Butner, North Carolina, on the 20th day of December, 2016, at 8:52 a.m., before Lisa A. DeGroat, Registered Professional Reporter and Notary Public.

C O N T E N T S

I N D E X   O F   T H E   E X H I B I T S

(MADOFF EXHIBIT 1 WAS MARKED FOR IDENTIFICATION.)

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THE VIDEOGRAPHER: We are now on the record.

Please note that the microphones are sensitive, and they pick up whispering and private conversations. Please turn off all cellphones or place them away from the microphones, as they can interfere with the deposition audio. The recording will continue until all parties agree to go off the record.

My name is Bob Collier, representing Veritext Legal Solutions. The date today is December 20th, 2016, and the time is approximately 8:52.

This deposition is being held at Butner Federal Correction Facility, located at 3000 Old 75 Highway, Butner, North Carolina 27509 and is being taken by counsel for the customers and trustees.

The caption of this case is In re: Securities Investor Protection Corporation, Plaintiff-Applicant, v. Bernard L. Madoff Investment Securities, L.L.C., Defendant.

And this case is being held in the United States Bankruptcy Court, Southern District of New York. Case number 08-01789 (SMB). The name of the witness is Bernard L. Madoff.

At this time the attorneys present in the room and everyone attending remotely will identify themselves and the parties they represent.

MS. CHAITMAN: Helen Davis Chaitman, of Chaitman, L.L.P., on behalf of various defendants in the good faith clawback actions.

MR. GOLDMAN: Peter A. Goldman. I represent Bernard Madoff.

MR. SHEEHAN: David J. Sheehan, with Baker Hostetler, attorneys for the trustee Irving Picard.

MS. FEIN: Amanda Fein, Baker Hostetler, for the trustee.

THE VIDEOGRAPHER: Our court reporter is Lisa DeGroat, representing Veritext Legal Solutions, and she will swear in the witness, and we can proceed.

* * * * *

P R O C E E D I N G S

Whereupon,

BERNARD L. MADOFF,

having been duly sworn,

was examined and testified as follows:

DIRECT EXAMINATION BY COUNSEL FOR CUSTOMERS

BY MS. CHAITMAN:

Q. Good morning, Mr. Madoff. I want to hand you what I've marked as Madoff Exhibit 1, which is an order that was entered by Judge Bernstein permitting this deposition.

And there are specific topics that are defined in this as permitted topics of -- of questioning, and I'm going to limit my questions to those topics. This is Exhibit 1.

Just let me know when you've finished reading through seven -- the -- the permitted topics on this --

A. Oh.

Q. Page three. It's -- it's on page three.

A. Okay.

Q. Yeah.

A. Understood.

Q. Okay. Good. Thank you.

Mr. Madoff, it's been actually over eight

years since you confessed on December 11th, 2008. At that point in time can you just briefly explain what your emotional state was about confessing at that moment?

A. Relieved, I guess you would say.

Q. Can you explain that?

A. Well, the -- you know, I had committed this crime over a period of roughly 16 years, and the -- I realized that, you know, certainly towards the end of it that I could not go on any further.

And I was confronted by my brother and my sons, because they realized that I -- I was not my normal state, mental state, and that was when I acknowledged, you know, my wrongdoing and the fact that I was operating a -- a fraud or a Ponzi scheme.

And notified my wife at the same time, went home that afternoon to discuss it with my wife and admit this to my wife. And then my sons turned me in to the U.S. attorney at the advice of their counsel, which was Paul Weiss.

And I, you know, met with the -- a group of attorneys and the trustee and -- and the SEC and the U.S. attorney a couple of days after that, and, you know, discussed what had happened.

And they asked me the same thing that you

just asked me, you know, about my mental state, and I said that, you know, that I was relieved to -- to have this thing over and get if off my chest. And they all, you know, acknowledged, you know, that they must have felt the same way.
Q. Now, were you represented by counsel at the time that you met with the U.S. attorney and the other --
A. Yes.
Q. -- people?
Okay. And who was your counsel?
A. Ira Sorkin.
Q. And --
A. From -- well, at that time he was with -- he changed firms.
MR. GOLDMAN: Dickstein Shapiro.
THE WITNESS: Huh?
MR. GOLDMAN: Wasn't it Dickstein Shapiro?
MR. GOLDMAN: Off the record.
THE VIDEOGRAPHER: Going off the record. The time is 8:58.
(RECESS FROM 8:58 A.M. TO 8:59 A.M.)
THE VIDEOGRAPHER: Back on the record. The time is 8:59.

BY MS. CHAITMAN:
Q. Let me start again with my question before we were so rudely interrupted.
At -- at the time that you confessed to the government officials were you represented by counsel?
A. Yes.
Q. And who was your counsel?
A. Ira Sorkin.
Q. How long had you known Ira Sorkin?
A. Oh, many, many years. Probably at least 20 years.
Q. And had he ever worked for the SEC?
A. I am not sure. No. He didn't work for the SEC. He was -- he was a U.S. attorney, though.
Q. Okay. And is that the same Ira Sorkin who represented Avellino & Bienes when --
A. Yes, it is.
Q. -- when the SEC --
A. Yes. He --
Q. -- investigated them in 19 --
A. In 1992.
Q. In 1992. Let me finish my question, and then I'll let you finish your answer. Okay? I promise.
Now, when -- I don't want you to disclose

any attorney/client privileged information between you and Mr. Sorkin, but was Mr. Sorkin surprised when you told him that you had been operating a Ponzi scheme?
A. Yes.
Q. In fact, had any family members of Mr. Sorkin invested through you?
A. I believe his -- his -- his mother and father had an account with me through Avellino & Bienes.
Q. Okay. And -- so he represented Avellino & Bienes with respect to the 1992 SEC investigation?
A. Yes. That's correct.
Q. And thereafter his parents invested with you?
A. Well, I think they were a client prior to that.
Q. Okay. And did they -- did they continue to be clients after that?
A. Yes.
Q. They did?
A. I believe.
Q. Okay. So is it fair to say that if Mr. Sorkin had come to learn that Avellino & Bienes had done something illegal, that he would not have had his parents continue to invest through you?

MR. SHEEHAN: Object to the form.

THE WITNESS: I -- you know, I don't know -- well, the -- the issue with Avellino & Bienes really had nothing to do with any wrongdoing by me.

It was the fact that they were deemed to be operating an unregistered investment partnership, and the SEC, you know, acknowledged to me that there was nothing wrong with what I was doing.

And that if they were willing to register, I could continue register -- registering -- continue investing for them. I refused to at that time and insisted upon returning their moneys and closing out their account.

So, as far as the SEC, or as far as any of Avellino & Bienes' clients are concerned, based upon everything that happened, none of them would have any reason to feel that I was doing anything wrong. It was Avellino & Bienes that had the problem.

BY MS. CHAITMAN:

Q. Now, you recall that you appeared before Judge Chin and entered a guilty plea in June of 2009?

A. Yes.
MS. CHAITMAN: Okay. And I'm going to mark the transcript of that proceeding as Exhibit 2.
(MADOFF EXHIBIT 2 WAS MARKED FOR IDENTIFICATION.)
BY MS. CHAITMAN:
Q. Mr. Madoff, do you have a good recollection of that day?
A. Yes.
Q. Okay. If you'd be good enough to turn to page 25.
A. Okay.
Q. Now, just to put this into context, you confessed on December 11th, 2008, and Mr. Sorkin began representing you at that time; right?
A. Yes.
Q. And you entered a guilty plea -- actually, it was March 12th, 2009. Do you see that, that's the date --
A. Uh-huh.
Q. -- on the first page?
A. Yeah.
Q. Okay. And during the period, from December 11th until March 12th, you had been living in

your apartment; is that right?
A. Yes.
Q. And is it fair to say that you had a lot of time to think about what you had done?
A. Yes.
Q. When you spoke to Judge Chin on March 12th, 2009, did you tell the truth about what you had done?
A. Yes.
Q. I want to read, beginning on line 12 of page 25, the -- the one paragraph. Quote, "To the best of my recollection, my fraud began in the early 1990s. At that time the country was in a recession, and this posed a problem for investments in the securities markets."
"Nevertheless, I had received investment commitments from certain institutional clients and understood that those clients, like all professional investors, expected to see their investments outperform the market."
"While I never promised a specific rate of return to my client, I felt compelled to satisfy my clients' expectations at any cost. I, therefore, claimed that I employed an investment strategy I had developed called the split-strike conversion strategy to falsely give the appearance to clients that I had

achieved the results I believed they expected."
Is that statement 100 percent true?
A. Yes. However, there's -- if I understand this statement, it said that -- that -- "to falsely give the appearance," implies that I had achieved the results. When I took the money and I started the strategy, the strategy -- there was nothing in the strategy to give a false impression.
In other words, I was the -- you know, I intended to invest the money. The fact that I invested -- that I couldn't invest it because of market conditions, but then shorted the strategy to the clients, then it was -- it -- it gave the false impression, but that -- it was not my intention when I first developed the strategy or made the commitments to the clients to -- to not invest the money at that time.
Q. Okay. So, if I understand you correctly, when you developed the split-strike conversion strategy, your intention was to carry it out --
A. Correct.
Q. -- honestly?
A. Correct.
Q. But you didn't have the money to do that, and so you --

A. I didn't have the market conditions to do that.
Q. Okay. So you started sending statements to clients which were not accurate, because they reflected purchases of securities that did not occur?
A. Yes. That's correct.
Q. Okay. Now, you understood that this was a fraud on your customers; right?
A. Yes.
Q. And is it your testimony that you never perpetrated a fraud on your customers prior to the initiation of the split-strike conversion strategy?
A. That's correct.
MR. SHEEHAN: Object -- object to the form.
THE WITNESS: I'm sorry. I didn't hear what you just --
MR. SHEEHAN: I said I objected to the form.
THE WITNESS: Oh.
MR. SHEEHAN: We have an understanding that all objections are preserved, as subject to objections as to form.
MS. CHAITMAN: Right, but what is your objection to that form? I just want to --

MR. SHEEHAN: You're testifying.
MS. CHAITMAN: Okay. Okay.
MR. SHEEHAN: All right.
BY MS. CHAITMAN:
Q. Mr. Madoff, can you tell us in your own words whether you had ever -- prior to the split-strike conversion strategy ever misrepresented a purchase or a sale on a customer's statement so that the customer was misled?
A. Yes.
Q. When?
A. Well, basically after the market crashed in 1987, certain customers that were not doing the split-strike conversion strategy, but were involved in a -- in a normal market-hedging strategy, where there were commitments on both my side and the client's side to keep the strategy open, and -- because of the market crash they were forcing me to liquidate part of their -- their strategy in violation of a commitment that -- that they had made to me and to others.
That was done, and that triggered in the years after that, which I guess started primarily -- that went really from the early '90s on through, you know, 2008, where those clients gave instructions to do some backdating of transactions, and, you know,

liquidating of securities or -- and so on to generate certain losses that they deemed desirable for tax purposes.

So I was aware of the fact that those -- and, you know -- and told the clients that they were, you know, basically, you know, running into a tax violation problem. So that had nothing to do with the split-strike conversion, and that was --

I don't know if I've answered your question.

Q. Okay. Well, we've gone into a different subject, but let me, if I may, just come back to my question, and perhaps I misstated it.

What I was really asking you -- I'm not asking you whether a client directed you to do something illegal.

A. Right.

Q. Because that would not be a fraud on that client; right?

A. No.

Q. Yeah.

A. That's correct.

Q. Okay. So I want you to limit --

A. It was a violation for probably the SEC regulations on my part, but it was not a fraud. It was -- it was the clients that, you know, instructed

what should be done to employees in my firm.
Q. Okay.
A. My employees in my firm.
Q. Okay. We'll come back to that, but I want you to focus now solely on the situation where you are making a misrepresentation to a client and the client doesn't know the truth.
A. Okay.
Q. Prior to the split-strike conversion strategy did you ever orally or in writing make a misrepresentation to the client where the client didn't know the truth?
A. No.
Q. Are you absolutely sure about that?
A. Yes.
Q. Now, to the best of your recollection do you remember when in 1992 you started to do the split-strike conversion strategy?
MR. SHEEHAN: Object to the form.
THE WITNESS: No. I would just say it was the early part of '92.
BY MS. CHAITMAN:
Q. Okay. But we can look at statements, and we would be --
A. Yeah.

Q. -- able to recognize that --
A. Yes.
Q. -- that -- a statement would show that trading strategy; isn't that true?
A. Correct.
Q. Okay.
A. It should.
Q. Okay. So is it your testimony that if we found the first split-strike conversion statement, that you would say that that's when the fraud began?
A. When I failed -- well, it's -- I had developed a strategy before '92, the split-strike strategy before '92. And I might have actually done some transactions, but I was -- it wasn't until sometime after '92, when the market conditions changed, that I was not able to continue doing the split-strike, and that's when the fraud began.
Q. So how would we determine -- what market conditions should we look for in order to determine when you actually stopped buying the positions that were reflected on the statements?
A. Well, you could look for the -- you can look for the transactions and -- well, you would -- you could look at the market conditions that occurred, you know, in '92.

It was actually -- this started during the Gulf War situation. I don't remember the exact dates of when I -- when I started or stopped it, but there -- '92 is a ballpark number.
Q. What were the specific market conditions that led to your not actually purchasing the securities that were reflected on the statements?
A. There wasn't enough volatility or really volume to do what I wanted to do for the strategy.
Q. Explain to me what you mean by that. You mean there weren't enough shares of the securities that you were --
A. It was a combination of not -- the strategy was basically a strategy that required sort of an upmarket, a market that would appreciate. So at that time the markets were in a very fragile state, because of the -- the Gulf War, and there was -- the recession had already started.
So in order for the strategy to work successfully you basically had to have an upward bias in the market for the -- for the basket of securities that were involved in the strategy to move towards the upward strike price of the call options that you sold for the strategy.
MS. CHAITMAN: Okay. Okay. Now I'd

like to mark as Exhibit 3 the transcript of the plea of Mr. DiPascali.

(MADOFF EXHIBIT 3 WAS MARKED FOR IDENTIFICATION.)

BY MS. CHAITMAN:

Q. Now, Mr. Madoff, I'd like you to -- if you'd look at the transcript, the first page, you can see this is an August 11th, 2009 transcript before Judge Sullivan in the United States of America versus Frank DiPascali. Do you remember when he plead guilty?

A. Yes.

Q. Okay. If you'd be good enough to turn to page 44.

A. Uh-huh.

Q. The -- the court is asking Mr. DiPascali to -- to read his plea, and the court says, and I quote, "Let me ask you to read slowly, so that the court reporter can get it down."

And then the defendant says, Mr. DiPascali says, and I quote, "I am standing here today to say that from the early 1990s until December of 2008" --

MR. SHEEHAN: Where are you?

THE WITNESS: Excuse me.

MS. CHAITMAN: Page 44.

THE WITNESS: Page 44.

MR. SHEEHAN: I think we may have the wrong copy.
MS. CHAITMAN: You have the wrong --
THE WITNESS: Right.
MR. SHEEHAN: This is Kugel.
MR. GOLDMAN: Right.
MS. CHAITMAN: Oh, this is Kugel. Oh, I'm sorry.
THE VIDEOGRAPHER: Your mike. Your mike.
MS. CHAITMAN: Okay. Sorry.
THE WITNESS: David, could you do me a favor and just get me a soda or something to drink?
MR. GOLDMAN: Do you want a Pepsi?
THE WITNESS: Yeah, anything is fine. I'm losing my voice.
MR. GOLDMAN: Could I just ask for a clarification. I know we're not using the exhibit right now, but the Bates stamp, "Public," at the bottom, does that mean that's open?
MR. SHEEHAN: Correct.
MR. GOLDMAN: Is it under the confidentiality order? I just want to make sure I'm clear on what the confidentiality --

MR. SHEEHAN: No. That's a public document.

MR. GOLDMAN: Okay. Okay. Fine. You can continue while I get his soda.

MR. SHEEHAN: Sure.

MS. CHAITMAN: Okay. Are we back on the record?

Okay. I'm going to mark as Exhibit 4 what I had intended to mark as Exhibit 3, which is the DiPascali plea.

THE WITNESS: Do you want page 44 again?

MS. CHAITMAN: Yes.

(MADOFF EXHIBIT 4 WAS MARKED FOR IDENTIFICATION.)

MS. CHAITMAN: And if you'd go to page 44. Everybody, just make sure that you've got the right document.

THE WITNESS: Okay.

MS. CHAITMAN: Everybody is okay?

MR. SHEEHAN: Yup.

BY MS. CHAITMAN:

Q. Good. Okay. So I'm going to read when the judge tells DiPascali he can begin. It's on line 18 of page 44.

"I am standing here today to say that from the early 1990s until December of 2008 I helped Bernie Madoff and other people carry out the fraud that hurt thousands of people."

"I am guilty, and I want to explain a little bit about what I did and how I want everybody to know that I take responsibility for my conduct."

And then if you'd skip to page 46, line nine. And I quote, "From at least the early 1990s through December of 2008 there was one simple fact that Bernie Madoff knew, that I knew and that other people knew, but that we never told the clients, nor did we tell the regulators, like the SEC. No purchases of" -- "or" -- I think it should have been -- "or sales of securities were actually taking place in their accounts. It was all fake. It was all fictitious. It was wrong, and I knew it was wrong at the time."

And then the court said, "When did you realize that?"

And DiPascali said, "In the late '80s or early '90s."

And then if you look on page 47.

A. Uh-huh.

Q. Page -- line five. The -- Mr. DiPascali

said, "Most of the time the clients' money just simply went into a bank account in New York that Bernie Madoff controlled. Between the early '90s and December 2008, at Bernie Madoff's direction, and together with others, I did the following things."

"On a regular basis I told clients over the phones and using wires that transactions on national securities exchanges were taking place in their account when I knew that no such transactions were indeed taking place."

"I also took steps to conceal from clients, from the SEC and from auditors the fact that no actual security trades were taking place and to perpetuate the illusion that they actually were."

Now, Mr. DiPascali in one place -- in two places he said it was the early '90s, and in one place he said it was the late '80s or early '90s.

When to the best of your recollection did Mr. DiPascali become involved in dealing with investment advisory customers?

A. Well, he -- he knew that I was doing customer business, you know, you know, in the '80s. Primarily the -- what I was just talking about with some large clients and also the convertible arbitrage clients, he was aware -- he was aware of that

business.

He was also aware that what happened in '87 and -- and during the crash that, you know, there was some -- there was some -- there was some clients that were wanting to sell out of their positions that they had had because of their concern about the market.

And that I had, you know, objected to that, telling them that this was in violation of their commitments that they had made originally. So he was aware of the fact that those discussions were taking place.

And he was also aware of the fact that I was doing -- actually doing the convertible arbitrage transactions prior to that.

Q. Okay. But in terms of the -- the crime that he's admitting to here --

A. Right.

Q. -- can you shed any light on whether, in fact, this began in the late '80s or the early '90s?

A. Oh, it -- it began, as I said, in the '90s.

Q. Okay. All right. And when you say in the '90s, are you fairly certain it was 1992?

A. That was -- yes. That was the date -- the approximate date that I said it started, because that's when I really started to take in the money to

do the split-strike trades.
Q. Okay. All right. Now I'd like to go to --
MS. CHAITMAN: You-all have Mr. DiPascali's transcript?
MR. SHEEHAN: Mr. Kugel's.
MS. CHAITMAN: I'm sorry. Mr. Kugel's transcript?
MR. SHEEHAN: Yup.
THE WITNESS: Uh-huh.
MS. CHAITMAN: Okay. Can I just have Kugel's transcript for a second?
BY MS. CHAITMAN:
Q. All right. So I've marked this as Exhibit 3. Now, if you'd be good enough to look at page 32. I'm going to read, beginning on line four. This is Mr. Kugel's plea, and he gave this plea on November 21st, 2011.
"Specifically beginning" -- it should be -- "in the early '70s until the collapse of BLMIS in December of 2008 I helped create fake backdated trades."
"I provided historical trade information -- sorry -- first to Annette Bongiorno and later to Joann Crupi and others, which enabled them to create fake trades that when included on the account statements

and trade confirmations of investment advisory clients gave the appearance of profitable trading, when, in fact, no trading had actually occurred."

"I helped Bongiorno, Crupi and others create these fake backdated trades based on historical stock prices and were executed only on paper."

Now, during the 1970s and '80s who within the firm was responsible to deal with the clients that you've described were involved in transactions that you felt were violations of either the tax laws or the securities laws?

A. Well, first of all, I was the only one that dealt with the clients, period, as far as doing the trading.

Q. Okay.

A. So none of this makes sense to me, because I think David Kugel started in the '70s working for me.

REDACTED

REDACTED

Q. Okay.
A. And there were some others, but primarily those.
Q. Okay. And --
A. Those are my four big clients.
Q. And did each of the four big clients have multiple accounts?
A. Yes.
Q. So they might have had accounts for their children or their --
A. Yes. They all did.
Q. Okay. So can I refer to them as the four families?
A. Yes.
Q. Okay. When did you begin doing business with the four families? Was it at different times?
A. Varied times. Yeah. It started from the

early '60s, you know, through 2008.

Q. Okay. Let me just take them one by one. Carl Shapiro?

A. Yes. He was probably the first one.

Q. And would that date back to the 1960s?

A. Yes.

Q. Norman Levy?

A. Probably started in the '70s.

Q. Okay. Stanley Chais?

A. In -- in the '60s and '70s.

REDACTED

REDACTED

REDACTED

Q. Okay. And who among your employees dealt with the four families?

A. Well, I dealt with the families as -- you know, initially with them, but when it came to doing bookkeeping work, backdating their trades or changing statements, which I looked at as an SEC violation, that they were -- they were dealing directly with primarily Annette Bongiorno, who was the bookkeeper at that time.

Jodi Crupi came on -- I'm not sure. It was a little bit later, but she was not really involved in the -- handling the four clients, certainly with their

account statements and so on. That was primarily Annette -- Annette Bongiorno's responsibility.
Q. Okay. So, just to be clear, Annette Bongiorno would have direct contact with the four families?
A. With -- yes.
Q. And when we say, "the four families," are you saying that Norman Levy himself would call Annette directly or would he have someone in his office?
A. Norman Levy or his accountant, which at that time was Adam Woltz, who is no longer alive.
Q. Okay. And with respect to Picower, would it be Picower directly or --
A. Primarily it was Picower directly and his assistant, which was -- who was April Freilich.
Q. Okay. And with respect to Stanley Chais?
A. It was primarily Stanley Chais himself.
Q. And with respect to Carl Shapiro?
A. It was Carl Shapiro or it was his accountant, who was with Coopers & Lybrand.
Q. Okay. And, just to be very clear about this, because Mr. Kugel is suggesting something quite different, I just want to be very clear, is it your testimony that these transactions for the four families were done specifically at their direction?

A. Yes. David Kugel had nothing to do with these clients. I don't think he's ever spoke to them at this stage. What did he say?

Q. Okay. Okay.

A. David Kugel's work for me was strictly involving arbitrage securities, convertible bond arbitrage securities. It had nothing to do with -- with the trades, the hedged trades that they were doing to get long-term gains.

In other words, there's -- David Kugel was hired as an arbitrageur in convertible securities, and that's all he ever was involved in. He was not involved in -- and he would have no reason to give Annette Bongiorno or anybody else in my firm any instructions to create any trades, because they were not -- because he didn't -- he only dealt in convertible securities.

And these people were -- were primarily dealing with, you know, just long positions. They did have convertible arbitrage accounts, like everybody else did in the very early stages, but most of their money was involved in these long position accounts, as we called them, which was handled by -- by me and by Annette Bongiorno. And David Kugel, to my knowledge, never touched anything with those trades.

Q. Now, with respect to the convertible arbitrage trading that you did for the investment advisory customers from -- from the 1980s, was that all actual trading that was conducted?
A. Correct.
MR. SHEEHAN: Object to the form.
Sorry.
BY MS. CHAITMAN:
Q. Sitting here today, Mr. Madoff, are you absolutely certain that the convertible arbitrage trading, which was done for your investment advisory customers, was executed trading which was actually performed by your office?
A. Correct.
Q. Okay. Is there any doubt in your mind about that?
A. No.
Q. Now, did David Kugel report to you with respect to his trading?
A. Yes.
Q. And was his compensation determined based upon his trading performance?
A. Correct. All my traders were compensated that way.
Q. So tell me how that worked. Did he have to

on a periodic basis supply to you reports of his trades?

A. He -- well, he -- you know, he doesn't -- he doesn't have -- the way the -- the way the firm was always operated, which was typical of all firms like ours, market-making or dealer firms, each market-maker, which David Kugel was one of them, that made market in convertible securities, which was really basically all he did.

They -- their compensation is based upon a percentage of their net trading profits. So I, particularly at that time, when the firm was much smaller, was very familiar with what the firm's trading profits were with each trader.

And David Kugel was one of a number of convertible bond traders in my firm. You know, I always monitored what their -- what their long and shorts were, what their profits were and all.

And, of course, it was then -- each trader had his -- had his own account that was kept by the bookkeepers in the firm, and that -- and that was Annette Bongiorno -- not Annette Bongiorno. She had nothing to do with that.

That was, you know, handled by the operations people in the firm. And they got a report.

We had a report at the end of each month, which was monitored on a, you know, daily basis as to what their profits were.

Q. So let me just understand this. Was there a system in place where you had the ability to monitor on a daily basis what David Kugel --

A. Yes.

Q. What trades he did?

A. Yeah.

Q. And how often would you monitor that?

A. Pretty much daily.

Q. So you would come into the office and monitor on a daily basis what each of the traders had done the day before?

A. At the time he's talking about, yes.

Q. Okay. And when you say, "at the time he's talking about," you mean the '70s and the '80s?

A. Well, in -- certainly in the '70s. You know, in the '80s my sons came into the firm, and the -- the SEC has very specific regulations when it comes to market-making firms.

And it's -- the regulation requires there to be a Chinese wall established with the firm, where each trader is only privy to his own trading profits or losses and his positions or risks.

And there has to be a -- we had two different types of operations. We had proprietary trading, which is trading for the firm's own account, and market-making, which is also for the firm's own account, but involve making a two-sided market in -- in securities, particularly convertible securities, which was our specialty at that time.

So the -- the trader -- each trader only knows what he is buying and selling. He has no idea what the firm is buying and selling. He has no idea what the firm's -- what those positions are. They're walled off.

You even have to have a separate supervisor for each one of those departments. So, for example, in the later years my son -- one son ran the market-making department, supervised that. One firm -- one son managed the proprietary trading side of the firm.

And then the -- the only one that was familiar with the overall positions of the firm and the firm's investment account was myself, because I was the only one that handled that.

So David Kugel would only be privy, like -- like any other trader, to what he was buying and selling, what his profit and loss was, not -- not the

rest of the firm.

Q. Okay. And if he did trades that were fictitious, is -- was there some -- if he -- if he gave you a false report as to what he had traded, would you have been able to pick that up?

A. Sure.

Q. How?

A. Well, because I was -- it's between those -- in the '70s is what he's talking about. You know, I -- I -- the firm was not that large that I wouldn't know -- I knew what was going on everywhere in the firm.

So I knew -- I would know whether or not he had -- what he was buying and selling. You know, I could see that the firm had -- you know, had the ability, you know -- we had to supervise -- I had to supervise what the firm's risk was, what their positions were, what their inventory was.

So if he was creating trades, as he -- as this states, certainly I would know that the trades didn't -- you know, were fictitious.

Q. How could you tell -- if he gave you a report, which said, I earned X dollars last month, because I did all of these trades, if he put down fictitious trades, how could you check to make sure

they were real?

A. Because there were trades -- well, any number of ways. Number one, if he created -- if a trader creates a ticket that is wrong, that says he bought stock and sold stock and didn't, then when the delivery -- when the securities were not delivered or not came in, they wouldn't settle.

So there would be -- it would be a vacuum between -- you know, because the way the stock market works, when you do a trade, eventually the trades get settled and the delivery is made of the securities and people pay for it.

To say nothing of the fact that we monitor what is being bought and sold for the firm on an ongoing basis. So -- so we would know what the exposure of the firm was, what the profitability of the firm was.

So a trader -- a trader can't, you know, create a -- now -- nowadays, you know, with large volumes and so on if you have a lot of traders, a trader can put through what they call a wooden ticket or a rogue trade. That's what you hear about.

You can do that if the firm is very large. You know, unless the firm has the proper automation, which we certainly had in the later days, you know,

you would -- you would be able to detect that.
Q. Okay.
MR. GOLDMAN: Bernie, if you get tired or you want to stand up and stretch at anytime, just tell us. Okay?
THE WITNESS: I'm okay.
Can -- can I interject something that I think that maybe will -- will clear up this thing with David Kugel?
MS. CHAITMAN: Sure.
THE WITNESS: And this -- because this -- this -- this issue of him creating fictitious trades surfaced originally when you were down here last time, seven years ago or six years ago or whatever it was.
BY MS. CHAITMAN:
Q. Okay. When you -- when you said, "you," you -- you looked at Mr. Sheehan?
A. David Sheehan.
Q. Okay.
A. Yes. Where a -- a scrap of paper was handed to me and to my attorney, Ike Sorkin, at that time that had a handwritten scribbling of a formula with a convertible bond on it that said, for example, X convertible bonds equals X number of shares of stock.

It was a -- it was a -- it was when we were setting up a -- the way we traded convertible bonds, which is typical of any -- any firm like ours, for a client. You know, you buy stock into a trading account, because we deal always as principal.

So the stock -- we go out, and we buy -- we -- as a market-maker we maintain positions in -- in convertible bonds and also in, you know, the related security for that.

And then those securities, if they're allocated to clients after the -- the positions are accumulated, you then break up -- you break up the trade. That may be 100 bonds, and you're going to give each client, for example, ten bonds or 15 bonds and so on.

So an instruction sheet is issued to -- basically to the operations side of the firm as to, you know, how you allocate a buy and a sell.

All right. So David Kugel, as one of my convertible bond traders. All right. If the firm was selling -- if -- whether it be from my investment account or from another trader's account, if we were going to -- if I wanted to sell a convertible bond to a client from my firm's trading account or investment account, then, you know, the instructions had to be

issued to the back office as to how many shares or bonds to -- to transact for a client.

So this scrap of paper was an instruction sheet that David Kugel, if he was one of the market-makers in a particular security, would be told okay by me, all right. I want to give this bond to this client and so on.

He would write an instruction sheet out to the back office, to Annette Bongiorno or Jodi Crupi, if she was there at the time, that this -- this is how you convert this bond.

In other words, this bond -- because the back office are not familiar, not being traders, with what the -- what the formulas are. So at the -- that is probably one of maybe 100 different scraps of paper that -- that would be issued or written by David Kugel or another trader, if there was another trader involved, you know, of what the allocation formula is.

Now, at that time, you know, when -- the first meeting that I had with the attorneys down here and my attorney, they showed me this piece of paper. And they asked me, what is this?

And I looked at it. And at first I wasn't really sure what it was, because the handwriting was hard for me, you know, to understand. Then I said

to -- it looks like to me like a formula, and it looks like David Kugel's handwriting.

So I -- I explained, just as I explained to you now, what this was. And I said, you'd probably find a lot of them. So they said, well, you know, so he's the one that is -- that is writing this? And I said, yes. It's an instruction sheet.

This is not uncommon for -- you know, this is the way the business is done. That -- now, this was not a fictitious trade. It was -- it was just instructing the -- the operations side of the firm what the allocation.

It would be no different than if I said, I'm selling to Carl Shapiro, you know, 1,000 shares of IBM that we had bought, you know, as a -- you know, as part of our business. I would -- I would put through an -- an instruction sheet, sell 1,000 shares of IBM to Carl Shapiro.

In David Kugel's side, if he was a trader in that particular security, he would issue the same instruction for that. These are not -- there's nothing fictitious about it.

So that -- none of that makes any sense to me. And I think that -- that, you know, one of the problems that I had when I, you know, met with both

the proffer agreement and so on, when I gave my -- and told how the firm operated, there seemed to be sort of a blank stare in the room when I said certain things.

And for an example -- now, in fairness to the people that were there, whether it be the trustee, whether it be the U.S. attorney or all the other people and the attorneys and all, the market-making business, the dealer business is -- is a specialized type of business.

It is not Merrill Lynch. You know, if you ask the average person how the stock markets work and how Merrill Lynch works, they have no clue. You know, they actually think that every time you buy, for example, a share of stock, the money goes to the company, and the company, you know, invests it.

When the average person buys a share of stock, the company gets nothing. It's just all he's doing is buying and selling, you know, from other clients that have the stocks, but people never understood that.

The market-making and dealers are a very specialized type of business, and they really don't have a clue. And the best example that I can use is that the U.S. -- the -- the prosecutor at the time asked me, can you please explain the history of the

firm and how you operated?

And I said, well, when? He says, from the beginning. So I started in 1960, which is when I started the firm, and I went into -- then after I got to a certain period, I said, like in the '70s I became a market-maker, and I, you know, bought stock, and I sold stock for clients, as well as the firm.

Sometimes I was long stock. Sometimes I shorted stock. And I said the word short, and it was like there was a magic, you know, word that I said. He said, short? And what does short mean?

And I'm sitting there in a room that has at least three or four SEC people sitting there. So I said, you don't know what short is? And everybody -- nobody said anything.

So I had to explain the shorts. He said, so you're selling stock, and you don't own it? You shorted it? I said, yes. As a market-maker I'm required at times to sell a stock short.

It's part of my -- my job. I have to -- I am required to make a two-sided market. Meaning I have to make a bid and make an offer as a registered market-maker.

So, yes, I do short stock for customers. I sell them stock they don't own. Hopefully I'm going

to buy it back, you know, at a profit, not a loss, but that is the typical way of doing business.

So, to get back to the -- this issue of David Kugel, when you talk about, you know, him putting instructions to the operations side of the firm, how to allocate a position or a formula, there's nothing unusual about that.

It's an everyday occurrence in a market-making firm. How or why he would say that he was creating a fictitious trade, I'm sort of dumbfounded. You know, I just -- it doesn't make any sense to me. And the timing is -- is -- doesn't make any sense to me, you know.

Q. Okay. Now, you've just said that you started your business in 1960. Can you tell us the various distinctions that you achieved in the securities industry?

A. What do you mean distinctions?

Q. Well, you were president of the NASDAQ.

A. Oh, you mean the -- my --

Q. Achievements.

A. All right.

Q. You're reading from notes.

A. I'm reading from -- because, you know, my brain is a little bit --

MR. SHEEHAN: Could -- could we mark that note?
THE WITNESS: -- is fried.
MR. SHEEHAN: It should be part of the record, if he's going to read from it.
MS. CHAITMAN: Yeah, yeah.
MR. SHEEHAN: But you read from it first. We'll mark it afterwards.
THE WITNESS: Okay. Well, okay. I was chairman of --
BY MS. CHAITMAN:
Q. Are these handwritten notes that you've --
A. Yes.
Q. -- prepared?
Okay. Okay.
A. The reason why I did this, by the way, is I -- I understand that I have to establish my credibility, you know, at this deposition, because I was --
MR. GOLDMAN: Just read.
THE WITNESS: I was told that I had no credibility, but apparently, from what I've read in the, you know, cases that I've been reviewing, people that are like David Kugel or Frank DiPascali or other people in my firm, Annette

Bongiorno, who have been accused and admitted guilt, they seem to be the witnesses that all of a sudden have credibility.

So -- but I have no credibility, and I don't understand how -- I mean, I admitted that I created a fraud, and for that I can understand why there's some question about whether I have credibility, but since everybody else is establishing their credibility, I feel I have to establish my credibility as well.

BY MS. CHAITMAN:

Q. Well, let me ask you something, Mr. Madoff. You've been in prison about seven years?

A. Seven and a half years.

Q. Seven and a half years. And you've had a lot of time to think, haven't you?

A. Unfortunately.

Q. Yeah. And you've been provided with the services of a prison psychiatrist?

A. Yes.

Q. And is it fair to say that you allowed a number of different people who are writers and scholars to interview you?

A. Yes.

Q. Is it fair to say that you at this point

have had a very long time to think about what you did?
A. Uh-huh.
Q. You have to say yes or no.
A. Yes.
Q. Okay. And do you have any motivation at this point to lie about what you did?
A. No.
Q. Okay. Tell us what accomplishments you had achieved.
A. All right. I served as chairman of NASDAQ and the NASD board of directors, chairman of the --
Q. Okay. And can you just explain for the record what NASDAQ is?
A. NASDAQ is the automated marketplace for the trading of non-listed securities and now listed securities as well. It's an automated part of the market, like the New York Stock Exchange.
Q. Okay.
A. So I --
Q. And when was NASDAQ formed?
A. NASDAQ was formed in the late '60s, early '70s. I was one of the founders of NASDAQ. And then became its chairman and served on the -- the board of directors of NASDAQ for nine years.
I also served as chairman on the board of

the National Association of Securities Dealers, also for nine years, starting in the early '80s through that.

I was also founder and chairman of the National Securities Clearing Corporation and Depository Trust. I was chairman of the International Securities Clearing Corporation.

I was chairman of the NASD trading committee. Chairman of the NASD National Market Design Committee. Chairman of the National Association for Securities Business -- National Business Conduct Committee, which is a regulatory arm of the -- of the industry.

I served as chairman of an SEC Large Trader Reporting Committee. I chaired -- was -- served as chairman of the NASD Small Order Execution Committee. Chairman of the NASD Surveillance Committee and chairman of an SEC NASD Payment for Order Flow Committee.

I was also a member of the Securities Industry Association board of directors, the Securities Industry Association Trading Committee, Securities Industry Association Federal Regulation Committee, Security -- chairman -- a member of the SEC SIAV/SIA Capital Markets Committee.

I was chairman and member of the SEC Intermarket Trading System Committee, which is the committee that links all of the exchanges, the New York Stock Exchange, NASDAQ and the five regional exchanges. And I was head of the SEC NASD arbitration committee. Those were the committees that I served on over the history of my firm.

Q. Did you advise any foreign governments with respect to the establishment of a stock exchange?

A. Yes. I was -- I served as the liaison and consultant to the London Stock Exchange, the London Futures Exchange, the Singapore Stock Exchange, the Tokyo Stock Exchange, the Frankfort Stock Exchange, the Paris boards and the Moscow Stock Exchange.

MS. CHAITMAN: We have to wait a second.

THE VIDEOGRAPHER: Going off the record. The time is 9:56.

(RECESS FROM 9:56 A.M. TO 10:16 A.M.)

(MADOFF EXHIBIT 5 WAS MARKED FOR IDENTIFICATION.)

THE VIDEOGRAPHER: Back on the record. The time is 10:16.

BY MS. CHAITMAN:

Q. Mr. Madoff, we've taken a break, and do you

remember where we were when we were interrupted?
A. Yes. We were -- I had listed the number of exchanges that I was advising on building new trading platforms, and I listed, you know, basically London, Singapore, Tokyo, Frankfort, Paris and Moscow.
This was basically partly at the request of the SEC, who was asked by these various exchanges if, in fact, they could have me willing to -- to travel over there to consult with them on building a platform that was similar to the NASDAQ platform that I was one of the ones that designed that platform for -- for NASDAQ.
And the SEC had a policy basically where they would send up, you know, teams of employees to come up -- basically compliance people, come up to watch us into our trading room to witness us trading on a daily basis and looking at the operations side of the firm and the automation side of the firm.
So they would -- we did that for a number of years, where they came and watched us trade, and we consulted with them. So --
Q. Now, when you say, "they," you mean people who were employed by the SEC --
A. Yeah. We had --
Q. -- would come to your offices?

A. The past four chairmen of the SEC have all been up in my office, watching us trade and meeting with us, as well as all of these foreign exchanges.

As a matter of fact, the -- the NASD used our -- during the 9/11 crisis the SEC and the NASD asked us, would we allow the NASD to -- to operate their backer facility out of our backer facility that we had in Queens, because that's the -- everybody was having problems because of the -- you know, the -- the bombing out of the -- the plane crashing into the buildings.

So the NASD for a period of, I guess it was, three months used our facilities to back up their trades, and also their compliance people sat in my office for a period of months, operating, you know, because they didn't have -- their offices were destroyed.

Q. Now, Mr. Madoff, I think you know that the trustee has taken the position in court he has not conceded that you ever did any legitimate trading. Can you explain to us -- starting in 1960 and then ending on December 11th, 2008 can you explain to us the volume of trading that you did in various periods of time and the number of employees whose job was to conduct real trades?

A. Well, when I started my firm in 1960, it was basically myself. And I operated at that time out of my father-in-law's accounting office, because I was in law school at the time. So in those days it was very common for small brokerage firms to operate.

As a matter of fact, I started with $500 of capital. And that was a small amount even by the SEC's standard during that time. So I was required to meet with the New York office of the SEC to explain how I basically had the nerve to present a handwritten balance sheet with $500 cash assets and no liabilities.

And, you know, so they wanted to make sure that I was real. And I started with the $500 of -- of capital, which in those days didn't require much, because I was -- my plan was just to do a small retail business basically with my family as clients.

That, you know, eventually grew from a one-man operation to, I guess, you know, 200 some odd people here and in -- in London in 2008.

I started this small retail firm. Relatively unsuccessful the first couple of years, because I ran into the Cuban missile crisis, and the marketplace collapsed in 2000 -- in 1962.

Required me to borrow $30,000 from my

father-in-law in the form of -- of municipal bonds to recapitalize my firm, which I paid back, you know, a year or so later.

And then gradually just -- and then became a market-making firm in the '70s, early '70, and became a market-making firm for the rest of the balance of my 50 years in the business.

At one -- we -- at the -- by the time we were finished in 2008 the firm was operating -- was executing a few 100,000 trades, up to 600,000 trades a day at the high, but we were averaging about 300,000 transactions a day, and we represented ten percent of the United States' volume in -- in transactions.

Q. Now, we're talking about legitimate transactions?

A. All market-making were legitimate transactions. The -- and the firm was operating basically as -- primarily most of the time as a market-making and proprietary trading firm.

It was -- the investment advisory firm really came into -- you know, into being on a gradual basis, and then was my undoing basically in the early '90s, because of a problem that occurred originally in '80 -- as I say, the crash in '87, but perpetuated a fraud that started, as I said, in the '90s, which was,

you know, a disaster.
Q. And when -- the fraud in the '90s you're referring to is the split-strike conversion?
A. Correct.
Q. Okay. Now, can you just briefly explain what the difference is between market-making and proprietary trading?
A. Well, market-making is -- in order to be a market-maker, according to SEC and NASD regulations, you have to maintain an inventory -- trading inventory and making a two-sided market. In other words, you -- you post bids and offers to the -- to the market in general.
Originally that was done in the over-the-counter market through what was called pink sheets, where they were daily published bids and offers of the brokerage firms in the United States, listing what you were willing to buy and sell securities.
And you had to be ready to buy and sell securities, whether either long or short, for -- for the market in general or for your clients.
Then with the development of NASDAQ, which was an -- which was the first automated system, basically we automated the pink sheets.

So electronically you put your bids and offers in a -- you know, on a screen-based system, and that developed what -- I was one of the firms that -- that developed, came up with that concept.

And, as a matter of fact, my brother, Peter, negotiated and wrote the first contract for NASDAQ with Bunker Ramo Company, who operated it at that time. While he was in law school he worked for -- for me until he graduated.

So the -- that's how we got involved in NASDAQ, but as a market-maker we traded basically close to 1,100 securities, all the convertible bonds. And then we got involved in making a market in listed securities, and they encompassed stocks that were traded on the New York Stock Exchange.

So we were considered to be one of the largest market-makers in convertible securities in the country and one of the largest market-makers in general, in both listed securities and over-the-counter securities.

We had, you know, hundreds of -- of other dealer clients, like Merrill Lynch, Fidelity, Smith Barney. We had directed automatic interfaces for them. Those were our wholesale clients as part of our market-making operation.

The proprietary side of the business is when the firm trades with their own account they maintain -- we maintain an inventory, you know, that could be hundreds of millions of dollars on the long side or short side. The firm is trading for its own account.

But as a market-maker you also are trading for your own account with the clients, as well as other dealers. But primarily the firm was known as a -- as a market-making firm, a proprietary firm that traded with other brokerage firms.

So if you, as a client, would call up Merrill Lynch to buy IBM or to buy Apple computer, they would buy the stock through someone like me. So our clients were basically other brokerage firms, as well as individual retail clients that we had that were people like the Shapiros and the Levys of the world. Those clients, as well as smaller clients that we did convertible arbitrage for as well.

And then in the '90s we started dealing with hedge funds that were doing the split-strike conversion or thought they were doing the split-strike conversion trades for us, which was where the fraud perpetuated.

Q. Okay. And you mentioned that you had about

200 people working in New York and in London?
A. Right. Approximately.
Q. And was that as of 2008?
A. Yes. We -- I think we started the London operation in 1983, and that was also started as primarily a market-making firm in U.S. securities in London.
We were either the first or one of the first members of the London Stock -- U.S. firms that became a member of the London Stock Exchange.
Q. Okay. But when -- when you -- do you remember when it was that you reached the level of approximately 200 people working in your firm?
A. Probably, you know, towards the end. I would say in the -- in the -- in the late 2000s.
Q. Okay. Now, when was it that you brought your sons into the business?
A. My son, Mark, came in when he graduated from the University of Michigan, which I think was in the mid '80s. My son, Andy, graduated from Wharton, I think in '87 and '88, and he came with us.
Q. If you had been doing the fraudulent split-strike conversion in '87 and '88, would you have brought Andy into the business?
A. Would I have brought him into the business?

No.
Q. My question is really, if you were doing something dishonest with your customers, would you have allowed your children to be brought into the business?
A. No.
Q. Now, I had asked Mr. Goldman to give you a copy of the Lazard report.
A. Right.
Q. And you've reviewed that, didn't you?
A. Yes.
MS. CHAITMAN: Okay. I'm going to mark this as Defendants' Exhibit 6, but, at Mr. Sheehan's suggestion, I have put a stamp on the handwritten notes that Mr. Madoff described.
And I didn't -- I don't have copies of that, but if you -- if you e-mail it to me, I'll circulate copies to everybody.
(MADOFF EXHIBIT 6 WAS MARKED FOR IDENTIFICATION.)
MR. SHEEHAN: Okay. Thank you.
MS. CHAITMAN: Thank you.
BY MS. CHAITMAN:
Q. So I'm handing out Exhibit 6, which is the Lazard report. Mr. Madoff, do you -- this is

Exhibit 6 for you. I can take those from you.
A. Okay. Uh-huh.
Q. Before you received a copy of this from your attorney had you ever seen the Lazard report?
A. No.
Q. Okay. And do you understand that -- what it is?
A. Uh-huh, yes.
Q. Okay. And this is something that the trustee had prepared when he was trying to sell the market-making and --
A. Correct.
Q. -- proprietary trading units?
A. (WITNESS NODS HEAD UP AND DOWN.)
Q. Now, in general did you find that this was an accurate description of the business?
A. Yes.
Q. So on the page which is Bates stamped number 181058, which is the business overview.
A. Uh-huh. What -- what page number?
Q. It ends in 58. It's in the very beginning.
A. 88?
Q. 58.
A. Oh, 58.
Q. 181058.

A. Yes, uh-huh.
Q. You've got it? Okay. It says, "Business overview"?
A. Yeah.
Q. It says, "The company's" --
MR. SHEEHAN: Where are you reading? I'm sorry.
MS. CHAITMAN: The second paragraph. I'm sorry.
MR. SHEEHAN: All right.
BY MS. CHAITMAN:
Q. "The company's market-making operation is a market-maker in approximately 2,100 stocks, including all of the S&P 500 stocks and in over 350 NASDAQ stocks."
A. Uh-huh.
Q. "It has over 100 direct relationships and several correspondent-clearing clients representing over 1,000 correspondents. The market-maker processes approximately 300,000 to 400,000 tickets per day." Excuse me. "Peak" -- excuse me. "Peak volume of 800,000 and capacity up to 1.4 million."
"Approximately 80 percent of the trades are in listed stocks, and the remaining 20 percent of the trades are in NASDAQ stocks. Approximately 2.6

million shares of the daily volume is for executions of shares not held, and 0.8 million shares of the daily volume is executed with the company's Time Slicing automated system for delivering average price execution. The market-making operation employs 17 professionals, including traders and support staff."

Is that a fair description --

A. Yes.

Q. -- of the business as of December 2008?

A. Yes.

Q. Now, what does it mean when it says, "The company's Time Slicing automated system for delivering average price executions"?

A. That was a system that was developed by my sons, Mark and Andy, that was a system that allowed brokerage firms or institutional clients to deliver a large order to us, let's say, to buy 100,000 shares of IBM.

And they wanted to -- rather than -- they wanted to execute that order over a certain period of time. So typically those -- the way that was executed by all institutional firms is they would give it to a broker on the floor of an exchange and tell them they want to -- they want to execute this over the course of the day.

It was called a VWAP order. It was a volume weighted average price order. But it was a manually -- it was a manual execution, where you were relying upon the specialist on the floor of an exchange or the market-maker upstairs to use his best judgment as to when to execute that order over the course of the day.

My sons came up with the concept of rather than doing it that way to -- to allow a firm to take a 500,000 share order and give it to us and say, we want, you know, this 500 shares -- 500,000 share order executed every so many minutes. We want it sliced into smaller orders and executed into the marketplace.

So they determined the size of the order to hit the marketplace. And in order to do that you had to have the automation, which we were one of the only firms that had that ability. So that was considered -- you know, it was unheard of at the time, to do an executed order like that.

Well, my sons developed that order -- that system, Time Slicing, with -- with my brother's, Peter's, help. We then brought it to the SEC and asked -- met with the SEC in Washington approval to -- you know, how we would operate this order, and with -- did they have any objection to us executing the order

this way?

At first they looked at us like we were crazy, because no one had ever done that before. And what was necessary was the firm was -- say like Fidelity would be saying, okay, they're -- they're -- they're instructing us to execute 500,000 shares of IBM.

So they had to trust us that we were not going to run in front of the order, which was a common problem that institutions had with giving up an order to someone, letting them know that you wanted to buy, you wanted to sell their order.

So we assured the SEC that that order would be -- was loaded into our system. The only one that would see that order was not any of our individual market-makers or traders, just one supervisor in the firm, which would be either my brother (SIC), Mark or my son, Andy, depending upon which department it was going to go to.

And the order would be -- you can look at it like in the old days, when you had computers, and you would load a card -- a bunch of like cards into a sorting thing, and every so many minutes the cards would -- you know, would drop down into the thing and then go into the order.

The SEC was so enthralled with this concept of doing it, that they said, yes. They said, if -- you know, we'd like you to, you know, build this, if, in fact, you can. We did. We invited them to -- and the head of their market-regulation department to come into our office and watch the system operate.

And they -- they said it was terrific. And we -- we, you know, went about selling that option of doing it with any one of our clients. And we had people like Fidelity and T. Rowe Price and any number of our other clients operate through the Time Slicing system.

And that was also the forerunner of us developing the Primex system, which is a whole other system that we -- we developed in the '90s, '97 to '98, in a joint effort with Merrill Lynch, Goldman Sachs, Morgan Stanley and Citicorp, where we --

There were five partners that we developed my -- developed a -- a trading system called Primex. That was the forerunner of these so-called dark pools that now became very popular, where we were -- we sold a ten percent interest to these five firms.

And between the five of us we would account for 50 percent of the volume in the United States between those five firms. It was a big deal in 1998,

when it was announced. It was in the front page of all of the financial press.

And that was how we planned to operate the split-strike trades through that. Unfortunately, the system once we -- we developed it and took in the partners, it was such a threat to the New York Stock Exchange that the New York Stock Exchange approached us to buy the Primex system for us -- from us, because it was going to be a major competitor to the exchange.

We couldn't -- we couldn't agree on terms. So we never sold it to the New York Stock Exchange or took them as a partner, but the New York Stock Exchange, you know, had a history of trying to hold back competition from us.

Eventually they negotiated with the -- the partners. You know, made special deals with the -- the four partners -- with three of the four partners, Goldman Sachs, Merrill Lynch and Morgan Stanley, to not go forward with it or not -- not send most of their business through that exchange. And they really literally blocked us from -- from really ever fulfilling our desire with that.

The -- Citicorp decided that they would buy the -- they would continue with us. So we went on -- we were going to develop it with Citicorp in

operation, but then my disaster of the investment advisory business sort of, you know -- you know, ruined that -- that whole operation.

Q. What did the Primex system do?

A. The Primex system was a -- an electronic auction process that would compete with all of the exchanges, like these dark pools.

I had been a major competitor for the New York Stock Exchange from the time I started my firm. And which is why -- really how I got involved working -- my relationships with the SEC all of those years.

The SEC -- when I went into business, the New York Stock Exchange did 99 percent of all of the business in -- in -- in New York Stock Exchange issues.

The SEC had always been unhappy with the fact there was no competition in the U.S. marketplace. So they wanted -- all the business was done between the -- there were five regional exchanges, New York, Chicago, Philadelphia, Pacific, New York.

So there were five -- and Cincinnati. Those five exchanges traded all the securities in the United States. Plus there was the over-the-counter market, which became the NASDAQ market.

What happened was the SEC and congress was very unhappy with there being no competition in -- in listed securities. So they decided to -- to initiate a -- you know, a competitive marketplace. And they formed a committee, which they asked me to chair, which became the Intermarket Trading System Committee, which was the system of linking all of the exchanges.

In other words, it used to be that if you wanted to buy -- IBM traded on both the New York Stock Exchange, as well as five regional exchanges around the country.

So you could buy IBM at one price in New York, another place in Chicago, another place in the Pacific. So a customer putting an order in to buy IBM at 11:00 in the morning, or whenever it was they put it in, was in a situation where he may buy the price at IBM at one price in New York, when he could have bought it at a cheaper price, a better price, in Philadelphia or the Pacific and so on.

So there was a great arbitrage business that went on, which was, you know, somewhat initiated by my firm, where we would buy IBM in Chicago and then sell it in New York a second later at a -- at a profit and so on and so forth. It was a business that was done by anybody that had an arbitrage operation, not only

myself.

The SEC obviously realized this was ridiculous. You know, it was unfair to the clients to -- to be able to do that. So they said, look, this is -- you just -- you guys can't operate this way. A customer should be able to get the best price that exists in the marketplace, you know, when he executes the order.

So I said, well, how are we going to do that? So they said, well -- they asked me, well, what -- what would you suggest? And I said, well, you could pass a rule that said that if you're going to execute an order for IBM from a client, you have to make sure that the client is going to get it at the best price that existed between the exchanges.

And the order has to be routed to, you know, wherever the best price is, whether it's in Chicago, New York, Philadelphia. It doesn't matter. So they said, well, that's -- that's a good idea.

I said, well, the problem with that is how is the order going to get -- if the customer is in Chicago, and the best price is in New York, how is that order going to get from Chicago to New York?

So they said, well -- so they said, well, yeah. That's true. But how is that going to happen?

I said, well, you have to link the marketplaces, so that when the customer starts to -- puts the order in Chicago, and the better price is in New York, the guy in Chicago has to route the order to -- to New York, I said.

And you can't do it over the telephone, because that's crazy today. So, you know, we have to build a system that would electronically route it, which became the Intermarket Trading System Committee.

So I designed the system with some other firms, with Goldman Sachs at the time, to route these orders, you know, through an electronic routing system, and that was called ITS.

So I represented at that time the NASD on that committee. My brother represented the Cincinnati Stock Exchange, which we were the major owners of, the Cincinnati Stock Exchange, which was the first electronic exchange.

And the -- I forgot where I -- how I got involved in this --

Q. I was asking you about the Primex system.

A. Oh, okay. So, I mean, the firm -- we were always competing with the New York Stock Exchange. And at that time I said that the -- that the idea of executing orders on a floor of an exchange is

ridiculous.

And that nobody is going to, you know, want to, you know, send orders down to an exchange where you have hundreds of people screaming and yelling at each other, you know, when you want to order -- when -- when you want to execute an order.

The more sensible way to do it is the way NASDAQ operates. And, of course, the SE -- the New York Stock Exchange said, well, Bernie Madoff is always complaining about the New York Stock Exchange, because he built NASDAQ. So he wants all orders to be executed over NASDAQ, rather than the exchange.

And I said, well, that's true. I did. And we were a big competitor of the New York Stock Exchange, but it was the most efficient way of executing the orders.

And the joke was on Wall Street was that I was always -- they said, Madoff is saying that the New York Stock Exchange is going to be a big roller skating rink before. No one is going to execute orders on the floor of the exchange.

And it was true that I did make those kinds of comments. Well, eventually that's what happened. The New York Stock Exchange went from operating 98 percent of the business, to now they operate -- they

execute 12 percent of the business.

And the stocks, when you buy IBM, very few shares are bought on the floor of an exchange. They're bought basically electronically off the floor of the exchange through people like NASDAQ or through these -- these automated dark pools that are operating, what they call the high frequency traders and so on.

So the SEC likes to always point out that no good deed goes unpunished, because they blamed me -- everybody seems to blame me for developing the electronic marketplaces.

So they said that now, you know, you listened to Madoff, and you -- you said you didn't want to operate business on the floor of the exchange. So you allowed the industry to now build an electronic marketplace, where everything is done electronically.

And where we used to take 20 minutes to execute an order, it now goes in a millisecond, and there's no basically exchanges being done. And that was very true. I mean, I don't know that you can blame me for that, but that was basically -- you know, it's -- it's true.

Q. So the Primex was an exchange?

A. Primex was going to be a -- an exchange,

where the five of us control 50 percent of the business. Whereas, now -- look, the idea is -- the concept of any -- every brokerage firm wants to keep all of their orders themselves.

In other words, Merrill Lynch does not want to share his -- his client's orders with Goldman Sachs or Morgan Stanley or with Madoff. They want to keep their orders what's called in-house or internalization.

In other words, when a dealer -- the -- the goal of every brokerage firm in the country has always been to take their customer orders and handle them from beginning to end.

They didn't want to -- they didn't like this idea of sharing their orders and their information with everybody in the street. They didn't want competition.

Everybody wanted to keep their orders, you know, themselves, but the problem with doing that is the customer gets -- is at a disadvantage of doing that.

So -- because the best thing for the customer is to have his orders exposed to the -- to the world in general or the marketplace in general, but it's more efficient for a firm to keep all of

their orders themselves.

They want to -- they want to buy the stock and sell the stock through their own customers and keep the stock in-house. They don't want to go through clearing corporations or organizations. They want to do everything in-house, because that's the most efficient way to do business.

All right. But that comes at a cost, to do that. In other words, it's -- it's very difficult, you know, to do that. You're not exposing the markets -- the orders in general.

So there has to be a balance that is developed. So our concept was to allow orders to be executed electronically efficiently and have that -- but have that order exposed to the marketplace in general before you execute it.

So it's all right to say, okay. We want to keep our customer orders in-house, but we -- we want to make sure that the customer is -- is getting the best price. And how do you do that?

The way to do that is to expose the order to the street in general. Say, we're looking to buy IBM. Who is willing to supply the best price? And you -- you compete electronically.

You have like an auction process. You do

that. The -- the technology is there to build it, which we did. So we developed this system called Primex.

And we had these five firms, you know, to all agree that before they execute the order themselves in-house the order will go through this electronic auction process.

So Madoff, Goldman, Morgan Stanley, Merrill Lynch, Citicorp, Smith Barney would all compete with that order. So before any one of them could -- could execute the order themselves they had to give -- they had to have a bidding process to do that.

And that was the system. And it was -- it was, you know, a great system, but, unfortunately, it would be the deathnell to the New York Stock Exchange.

And the New York Stock Exchange, you know, tried to buy it from us, but that would have been the end -- they were -- their idea was they'll -- they'll buy it and never operate it, put it on the shelf.

But as much as we were able to compete with the New York Stock Exchange and drive them literally sort of out of business, they also killed the Primex system.

So we wound up selling part of it to NASDAQ. And NASDAQ operates their opening of the marketplace

through Primex, but Primex's big appeal to us would be that we would be able to bring in all of our foreign order flow. You know, the -- all the various exchanges into Primex, and that was how I hoped to eventually handle the split-strike trades.

Had Primex gone forward I never would have had this problem. I would have been operating today all the split-strike -- strike trades through Primex.

But my brother's -- we have the patent on Primex. And basically everybody that's operating these dark pools around the country today is in violation of patent infringement on Primex.

My brother's plan -- maybe this is fantasy -- is when he finishes his ten year sentence, he is going to sue all of these -- basically all of Wall Street for patent infringement on Primex, because all of these dark pools that are operating around the country today, doing all the business, are basically, according to my brother and the patent attorneys, are -- are guilty of a patent infringement on Primex, but we'll see what happens.

Q. That's fascinating.

Mr. Sheehan had wanted me to ask you a question. I think it's obvious from the way you're answering your questions, but are you on any

medication which would prevent you from testifying honestly?
A. No.
Q. Okay. If you -- if you'd go back to Exhibit 6. It lists on page 64 -- you're on 58. So it goes to 64.
A. Okay.
Q. It lists the top 20 clients.
A. Uh-huh.
Q. And they include Citigroup, Brown Brothers, Raymond, Merrill Lynch, Oppenheimer, Wells Fargo, Wachovia, Vanguard, USAA, UBS. Is this an accurate --
A. Yes.
Q. -- list of the 20 top clients?
A. It's the blue bloods of Wall Street.
Q. Okay. And then on the next page, which is page Bates numbered 65, it -- in terms of volumes, it said you execute 300,000 tickets a day. Is that about accurate?
A. That's on the low side, but, yes.
Q. Okay. And you execute 85 million shares a day; is that about --
A. Yes.
Q. That's accurate?
And 80 percent is listed. And if you look

at --
A. Right.
Q. I'm reading from page 65.
A. Uh-huh. Yeah, I'm there.
Q. Yeah. Okay. I just want you to be on the page with me.
A. I have this memorized, all of it.
Q. Oh, you do?
So it says, "80 percent listed, 20 percent NASDAQ"?
A. Correct.
Q. Is that accurate?
A. Yes.
Q. Okay. It says, "2.6 million not held shares a day"?
A. Uh-huh.
Q. Is that accurate?
A. Yeah.
Q. What does that mean, not held shares?
A. It means it's at our discretion on how we buy and sell. In other words, they -- it's like an order going through Time Slicing, where -- where Merrill Lynch will say, buy 100,000 shares of stock and you determine the price and the time you want to execute the order.

Q. Okay.
A. They're relying upon our ability to execute it at the best price for the client.
Q. Okay. So would you say that the Lazard report accurately reflects --
A. Yes.
Q. -- the business --
A. Uh-huh.
Q. -- as of December 2008?
A. Yeah.
Q. Okay. Now, in the course of your career in the securities business did you -- did you ever come across Bruce Dubinsky?
A. No.
Q. Did you ever hear of him?
A. No.
MS. CHAITMAN: Okay. We're going to mark as our next exhibit --
MR. GOLDMAN: Why don't you wait until you come back for the microphone?
MS. CHAITMAN: Yeah, you're right. What did I do with the Dubinsky report? Hold on.
So we're up to Exhibit 7.
(DISCUSSION HELD OFF THE RECORD.)
(MADOFF EXHIBIT 7 WAS MARKED FOR

IDENTIFICATION.)

MS. CHAITMAN: Oh, you know what? I'll give this to the witness, and I'll give this to you.

THE WITNESS: I already have a copy.

MS. CHAITMAN: I'm sorry?

THE WITNESS: I have a copy of this one.

MS. CHAITMAN: You can just give it to the reporter.

MR. GOLDMAN: David, here is one you can look at.

MR. SHEEHAN: I'm fine. I brought my own.

MR. GOLDMAN: Oh.

THE WITNESS: Are you still awake?

MR. SHEEHAN: Always.

THE WITNESS: The last time we were together, I had a meeting with you, you fell asleep during my testimony.

MR. SHEEHAN: Yeah, you warned me about that. I remember that exchange.

THE WITNESS: That's okay. I --

MR. SHEEHAN: You told me the SEC fell asleep in that meeting too. I remember that.

THE WITNESS: I -- I can -- I can put people to sleep. The chairman of the London Stock Exchange fell asleep during one of my meetings with him, but he said it was jet lag. You don't have jet lag. So --

MR. SHEEHAN: I have no jet lag.

BY MS. CHAITMAN:

Q. Mr. Madoff, I had sent you in advance of the deposition a copy of Mr. Dubinsky's report. Have you had a chance to review it?

A. Yes, I have.

Q. Okay. And did you agree with his conclusions?

A. Some of them.

Q. Okay. Did you agree with all of them?

A. No.

Q. Okay. Did you find that overall there were some mistakes that Mr. Dubinsky made?

MR. SHEEHAN: Objection as to the form.

THE WITNESS: Yes.

BY MS. CHAITMAN:

Q. Okay. Before we go into detail with respect to the report can you tell me some of the mistakes that you found with Mr. Dubinsky's approach?

A. Well, first of all, the majority of the

report had to deal with the split-strike conversion trades, which I was sort of at a loss for -- and this report, from what I understand from -- cost a lot of money to -- to produce.

And I had from day one acknowledged that there was no split-strike trades being done and that there was a fraud. So I couldn't understand why so much money was --

Look, let me just say that from the time that I plead guilty for this -- for this fraud, I've had to live with the guilt of -- of knowing what I did.

All right. And my decision basically to -- to plead guilty and to not go to trial was to be able to recover as much money as possible to my -- for my clients.

And the -- you know, rather than go to -- to trial, which I knew that I was guilty of, and put my family through a -- the horror of, you know, what would -- what would occur with the trial, I -- I decided that the best thing that I could do would be to plead guilty, take my sentence and do everything that I could to recover the money for the clients, who I defrauded.

Q. Let me just interrupt you there.

When you saw in -- in 2008 that the economy was collapsing, and you had -- you had out-of-ordinary redemptions in 2008; isn't that true?
A. Yes.
Q. Okay. Would you say that the redemption demand was extraordinary or --
MR. SHEEHAN: Object to form.
THE WITNESS: Well, yes. I mean, look, unfortunately or fortunately, however you want to look at it, my commitment to the people that I took the money from for the split-strike was that they could have their money back at anytime.
In other words, most hedge funds do not -- do not allow people to withdraw their money. They have what they call lockup periods. They -- they say that you have to give them 90 days notice, sometimes six months notice before you can get your money back.
Because of the way the split-strike strategy was designed there was no reason to have a lockup period if, in fact, I was doing it the way I intended to do it originally.
So that people that gave me money, whether it be an individual or whether it be a hedge fund, to invest, had the ability to call me

up and say, you know, that they wanted their money back within the settlement period of three days or four days.

So when this -- when this bank run occurred with the crisis in 2008, when everybody thought the world was coming to an end, the market was -- was crashing, because of the Lehman -- you know, first Bear Stearns and then the Lehman collapse, everybody needed money.

So I was one of the few places that they could -- that a hedge fund could go to -- to demand their money back and not have to wait with a lockup period. So everybody was calling me up, saying, we want -- we need the money, you know, to meet margin calls elsewhere on Wall Street.

They needed money back to meet their margin calls on Wall Street. So send me my money back and liquidate the position, and I'll send it back to you to reinvest as soon as things calm down.

So I was the -- the one place that they could go to get the money. So I started getting everybody calling me up, you know, send me 500 million, send me a billion dollars back. And I did. I started sending the money back.

But, obviously, you know, I couldn't keep doing that, because, you know, of the -- the nature of -- of the Ponzi scheme. So I knew that -- that the game was over.

As it turns out, I was --

BY MS. CHAITMAN:

Q. If I could just interrupt you. Do you recall approximately how much money you did send back to customers in 2008?

A. Close to six billion dollars.

Q. Six billion. Okay.

A. But I knew that -- that it was over for me, and --

Q. At that --

A. As it -- as it turns out, I was mentally -- I was in a mental state that I was -- I could no longer continue with -- anyhow. So it was almost like a relief to say, this is it.

I just can't continue this charade any longer. And that's what -- that's what caused me to acknowledge to my family that I had been committing this fraud.

Q. Okay.

A. So, to continue, I decided to plead guilty to this. And when -- before the sentencing my

attorneys pleaded with me to cooperate with the government.

The government wanted -- the prosecutor wanted me to -- to plea bargain with them to, you know, make some sort of a deal by providing information as to who else was involved in this fraud.

I mean, the belief was that I couldn't be doing this all myself, that there had to be other people involved in this fraud. So -- because, look, nobody could understand -- you know, it seems that for the past eight years nobody can figure out why did Bernie Madoff do this?

There have been books written about this. Every reporter that's called me, every academic, you know, that's called me from every business school literally in the world, everybody says, why would Bernie Madoff commit the largest fraud in history?

Why -- he had a very successful business that was the envy of everybody on Wall Street. He was on all of these committees. He was supposedly boy wonder, of course, you know, of Wall Street at that time.

Why would he do this? The SEC was dumbfounded. You can speak to any of the past chairmen over the past eight years and ask them, would

Bernie Madoff do this? You know, they would all look at you as though there was something wrong with you.

And that's what everybody wanted to know. It didn't make any sense. There had to be something else that created this problem. Was he blackmailed? Was he, you know, involved with -- you know, with the Russian mob? Was he involved with drug dealers?

Something happened, you know. You don't -- you don't -- you know, and when I said -- you know, when I gave explanations for it, nobody really understood it, you know, but I knew, you know, what happened.

I knew, yes, there were people involved that put me in this situation. That being said, it was my fault. I can't blame anybody for -- for what occurred. I mean, I did this knowingly.

I was not blackmailed by any -- was not involved with any mob thing. I made a tragic error of judgment that was precipitated by a number of clients that, you know, put me in this situation.

That being said, there was not a gun to my head. You know, I could have refused to accommodate, you know, some people that I tried to accommodate. And -- you know, so, therefore, I have the responsibility.

So my decision at that time was not to make a plea bargain. I was convinced that I could get the money back that was involved that people lost. I couldn't get the profits back, for sure, but I certainly felt I could recover the principal, you know, back.

So -- and I knew that my clients had withdrawn -- many of them over the earlier years before the fraud started that they had -- they had made and -- and withdrew legitimate profits over the years.

So I felt that while people were not going to make an average annual return of 12 percent, as they thought that they made, they certainly would -- would do all right, and I certainly would be able to recover everyone's principal.

So when I told my attorneys that, Ike Sorkin, I said, look, I'm going to recover everybody's money, you know, you know, but I -- I have to do this my way. I can't -- I can't establish a plea. I don't want to make any deal.

I said, I'm the only one that really has the knowledge of what happened and what people did to put me in this situation and the wrongdoing that certain people were involved in, I said.

And if I go to these people and -- which I've already done to a certain extent anyhow -- and threaten them with -- you know, with their complicity, I said, I'll get the money back. Now, nobody believed that I could possibly do this.

MS. CHAITMAN: We're just running out of the tape. So we have to --

THE WITNESS: Okay.

MS. CHAITMAN: -- take a break.

THE VIDEOGRAPHER: Okay. This ends media number one in the deposition of Bernie L. -- Bernard L. Madoff. Going off the record. The time is 11:12.

(RECESS FROM 11:12 A.M. TO 11:27 P.M.)

THE VIDEOGRAPHER: Back on the record. This begins media number two in the deposition of Bernard L. Madoff. The time is 11:27.

BY MS. CHAITMAN:

Q. Mr. Madoff, we've been --

A. Okay. I --

Q. -- discussing a few other things, but I want to come back, if I may, to the Dubinsky report.

A. Right.

Q. And my question is: Are there some fundamental errors that you feel Mr. Dubinsky made?

A. Yes.
Q. Okay. Let's -- let's go through them one at a time.
A. Okay. All right. Basically what -- well, I'd like to say is that I would -- I'm not going to get involved in his -- the majority of the report that deals with the split-strike conversion trades or whether or not the trades were executed or not, because the -- I have no objection to -- I can't find fault with what he -- what his determination was, because I was not executing the trades.
So there's no point in me, you know, evaluating what he says was right or wrong. There may be errors in there, but it doesn't matter. The fact was the errors that I found were -- had to deal with the beginning of the report dealing with the convertible -- the trading that took place before 1992, which basically involved the convertible bond arbitrage transactions.
So, first of all, let me start by saying that it was quite -- I understand that his -- from his CV that he has a very good CV. All right. In other words, he seems to be -- have his references of fraud reporting or -- I don't find any fault with that. He seems to have a lot of experience.

That being said, it became very obvious to me that his knowledge of the market-making and the dealer markets and the over-the-counter trading, whether it be convertibles or so on, there -- he had very little experience in that.

And that's not a great surprise to me, because it's sort of a specialized marketplace. And unless, you know, you -- you have firsthand experience of how market-makers operate, how the dealer market works and how the trading of convertible bonds takes place, you know, that's a specialized kind of marketplace.

And he had things that were really wrong. For example, he makes the statement that Madoff sent a confirmation to a client, where he -- you know, the client -- he says that the client bought stock or sold stock, which was opposite of what happened.

In other words, typically when a retail client gets a confirmation from Merrill Lynch, for example, it states the client bought IBM at a price or sold IBM at a price.

When a dealer sends a confirmation to a client, it says, we bought, we sold. Meaning the dealer bought or sold to the client. So, for example, there's a confirmation, and I have a -- a copy of one

of our confirmations.

Well, I don't need that. In other words, our confirmation says we bought. That means Madoff bought for the customer or from the customer or sold to the customer.

Q. Okay. You know what? I don't know if this is going to help you, but --

A. Here is --

Q. Okay.

A. Here is a confirmation. There's a confirmation --

MR. SHEEHAN: Let her mark that.

MS. CHAITMAN: I will.

THE WITNESS: It says in the box, "We sold." All right. Or it would say, we bought. "We," referring to the firm. Madoff.

Now, if we had said you bought or you sold, that would be the customer bought. You know -- you know what I'm saying?

MR. SHEEHAN: Uh-huh.

THE WITNESS: All right. This is a standard dealer confirmation. It also has on here codes, the transaction code and a capacity code. Meaning that it has a number.

Meaning what is -- what -- what

capacity are we operating? Where -- on the back of the confirmation it says the capacity -- the transaction is transacted over the counter in New York and so on. It also has a capacity code, which is trading as principal or agent and so on.

Dubinsky -- okay -- is used to seeing a retail confirmation, which would have the opposite of that. So he makes a big point in his report of saying that Madoff reflected this wrong for the customer.

All right. He says that, you know -- now, that's -- there's -- nobody that was familiar with the dealer markets would make that kind of a statement. It's -- it's -- quite frankly, it's an embarrassment, you know, to -- to put that in the report.

All right. He then says that it -- this was in violation of his agreement with the customer to act as agent. If you look at the agreements that we have with our clients, and there's a whole series of when a customer opens an account agreement, where there's a trading authorization and so on, it says that Madoff, meaning Bernard L. Madoff, the client is giving Madoff -- is appointing Madoff his agent to

transact business for the customer.

So it says Madoff is the agent for the customer. It doesn't say that -- you know, so that means that Bernard Madoff, myself, when -- he's authorizing me as the only person that is authorized to transact the business with the firm.

So the firm is transacting business as principal for their own account, which it clearly states that on the confirmation. He -- this totally confused him for some reason.

BY MS. CHAITMAN:

Q. Mr. Madoff, can I just stop you for a second.

I'm going to show you a statement, but if -- if a -- if a customer's statement says bought 100 shares of IBM --

A. That means the customer bought it on the statement. The statement is showing it as the customer bought. Okay. The statement is assuming the customer -- that he's bought it from Madoff.

He knows it, because Madoff is sending the confirmation -- is sending the statement to the customer, saying, you -- he's reflecting the customer -- what the customer bought and sold. It's

not reflecting who he --
Q. Okay.
A. -- bought and sold it from --
Q. Okay. So you're --
A. -- because we already know that.
Q. You're distinguishing between the confirmation and the statements?
A. The statement -- yes. The statement is -- was -- the statement only shows a transaction on the settlement date. All statements are operated that way with every brokerage firm. The confirmation shows both the trade date and the settlement date.
MS. CHAITMAN: Okay. Let me mark as Exhibit 8 the document to which you've been referring.
(MADOFF EXHIBIT 8 WAS MARKED FOR IDENTIFICATION.)
BY MS. CHAITMAN:
Q. And if I can just summarize this, this is dated -- the trade date is October 14th, 2005. The settlement date is October 19th, 2005. And it says -- you've crossed out the account number, but it says, "Sold" -- "we sold 42 shares" --
A. To the customer.
Q. -- "of Wells Fargo"?

A. To the customer. Right.
Q. Okay. So, "we," is Bernard L. Madoff?
A. Right.
Q. So -- so let me just understand something. So if the customer was buying 42 shares of Wells Fargo, you wouldn't go into the marketplace and -- and buy it for the customer?
A. Well, we -- we could, but we buy it -- we'd go into the marketplace and buy it for our own account and then resell it to the customer.
Q. Okay.
A. That's how principal trades work.
Q. Okay. As a general statement with respect to the investment advisory customers --
A. Uh-huh.
Q. Now, obviously from whenever in 1992 you stopped executing split-strike trades, there weren't any purchases and sales?
A. That's correct.
Q. So --
MR. SHEEHAN: Object to the form. Sorry. What I'm going to do in the future is just say form or object.
MS. CHAITMAN: That's fine. It doesn't matter.

MR. SHEEHAN: I don't want to interrupt the flow.
MS. CHAITMAN: Yeah, that's all right.
BY MS. CHAITMAN:
Q. I want to exclude the period after you stopped executing trades that were reflected on the statement. So whenever that was. Okay. Whether -- you know, whatever month of --
A. Okay.
Q. -- 1992 it was. Let me take the time before that.
A. Yeah. Well, he's -- the Dubinsky report that was making the statement of a trade that was a convertible bond trade that was actually made. So the example he's using -- he's not talking about a split-strike.
He's talking -- he's saying that -- on the convertible bond trade didn't really exist, because Madoff's confirmation is incorrect.
Q. Okay.
A. So --
Q. So let me -- so let me just try to understand something. I want to take the period -- I want to limit my questions and your answers to the period when you -- before the split-strike fraud

began.
A. Correct.
Q. Okay. So we're going to go earlier than whatever date that was in 1992, when the split-strike trades were not executed.
A. And the Dubinsky report that's making this statement is referring to a convertible bond trade that was in the period that you're talking about.
Q. Okay. So as to the convertible bond trades, is it generally true that the customers were buying from Madoff and selling to Madoff?
A. Correct. From Madoff's inventory that he already had or that he just bought or sold.
Q. Is -- is that true for everyone in the -- if -- if I take the convertible --
A. Operating as a dealer. Yes.
Q. So with your investment advisory customers, who were doing convertible arbitrage --
A. Uh-huh.
Q. -- their transactions always were with Madoff?
A. Correct.
Q. So --
A. All of our customers -- we always traded for --

Q. From your own inventory?
A. Other than theoretically in options, we traded from our own inventory.
Now, again, a dealer operates -- you -- a customer may tell the -- we may decide to sell stock to a customer or buy stock from a customer.
Now, we may already have that stock in our inventory, and we're selling it to the customer from inventory or the customer may -- we may not have the stock in inventory.
So we have to go out and buy it into -- from Wall Street, from the marketplace, into our inventory and then resell it to the customer. So that might happen over a period of the same day or it might happen over a period of a week and so on.
Which brings me to the next point. Okay? That --
Q. Can you -- can you remember that? Because I have a question about this.
A. Okay. Go ahead. Then give me that then.
Q. Give me a word, so I can remind you about your next point.
A. I'll remember.
Q. You promise?
A. Yes.

Q. Okay. So -- so let's say that in the convertible arbitrage strategy you had a need for 5,000 shares of IBM, because you were going to sell them to the convertible arbitrage customers.
A. Right.
Q. Okay. Mr. Dubinsky was looking for the purchase of 5,000 shares of IBM on a specific date in the market; right?
MR. SHEEHAN: Objection.
THE WITNESS: Uh-huh.
BY MS. CHAITMAN:
Q. Is that what he should have been doing?
A. I'm not sure I understand your question.
Q. Okay. Well, let me start it over again.
Dubinsky made the point in several instances that with the convertible arbitrage strategy the statements all together showed more purchases of a particular security than he could find records for --
A. Okay.
Q. -- on the New York Stock Exchange.
A. Okay. All right. So that's a -- that's a different subject, but -- all right. He -- if we're -- he -- what Dubinsky was -- was trying to establish or -- was that the -- the number of bonds that we -- let's say convertible bonds, because we're

talking about convertibles, because we're referring to bonds rather than stock.

Q. Okay.

A. Okay? So Dubinsky is claiming that if we show on a confirmation or in a customer account that we bought stock -- we sold stock to a customer or bonds to -- to a customer, that he looks to try and establish that there weren't enough bonds that actually traded in the marketplace at the time that we claim that we bought the bonds for the customer.

All right. So the way he researches that is he looks on the New York Stock Exchange, you know, number of bonds that traded on the New York Stock Exchange, and shows that that was, let's say, 100 bonds, and Madoff bought 200 bonds for a customer.

So, therefore, he couldn't have possibly bought 200 bonds for a customer, because only 100 bonds traded on the -- on the New York Stock Exchange.

All right. Now, the -- the fallacy of that is that, number one, convertible bonds, which is what he's researching here, do not trade on the New York Stock Exchange. They trade over the counter.

And to demonstrate that I happen to -- I brought this. This is a very expensive book, I was told. I happened to find it in the library here, for

some strange reason. It's the -- it's the Bible of -- of the bond markets. All right.

MR. GOLDMAN: Tell us the title, so we have it.

THE WITNESS: It's the, "Bond and Money Markets: Strategy, Trading, Analysis."

BY MS. CHAITMAN:

Q. And who is the author?

A. Moorad Choudhry or something of that sort.

MR. SHEEHAN: Could we have the spelling of that since we won't be able to take the book with us?

THE WITNESS: Moorad --

MS. CHAITMAN: Okay. So the -- the book is written by, M-o-o-r-a-d, and then his last name is, C-h-o-u-d-h-r-y. And it's published by Butterworth-Heinemann Finance, and it's called the, "Bond and Money Markets."

MR. SHEEHAN: What edition is it? Sorry. So I don't want to have the wrong book.

MS. CHAITMAN: You know what? I'll let you look at it. It -- it's -- it's first edition.

MR. SHEEHAN: Okay. Fine.

MS. CHAITMAN: First edition.

THE WITNESS: All right. You know, I happened to have made a copy of this. It's discussing the secondary market, which is what's -- you know, when you -- when you buy and sell stock for clients, you're buying in the secondary market, as opposed to the primary market.

The primary market is when a company goes public, they sell stock in the primary market. All right. Then after the company sells that stock to the public, it then trades -- the stock trades for the rest of the -- its life in the secondary market. All right.

MR. GOLDMAN: Bernie, you keep saying, "stock." You mean bond too; right?

THE WITNESS: Same thing.

MR. GOLDMAN: Okay.

THE WITNESS: You know. So, you know, it basically is talking about -- you know, this section was -- was talking about convertible bonds.

It says here -- it says, "Corporate bonds virtually everywhere are traded on an over-the-counter, OTC, basis. That is directly between counterparties over the telephone."

Meaning people like Madoff.

"Bonds are usually listed on the exchange." I'll read what it says. "On the New York Stock Exchange a low volume of trading in bonds takes place on the exchange itself, but this is dwarfed by the volume of trading in the bonds in the over-the-counter market."

In other words, what they're stating is that, although, this is a bond that is listed on the New York Stock Exchange, you know, most of the trading takes place in that bond in the over-the-counter market.

It's a listed bond. So you can buy it on the New York Stock Exchange, but no one does that. It's traded over the counter. So Dubinsky, you know, looks -- when he looks -- for example, it would be the same thing if he looked on the equity side of the market.

Let's say in -- in a split-strike trade. If he looked in -- because IBM trades on the New York Stock Exchange, if you just looked at the volume on the New York Stock Exchange to try and account for that -- for the customer trading, if the customer traded in the over-the-counter market, which is where we trade,

and where everybody else trades today, where it used to be 99 percent of the market, as I said earlier, traded on the floor of the exchange, now ten percent trades on the floor of the exchange, and the rest of it trades everywhere else.

And the convertible bonds have always been that way. In other words, so that Dubinsky looks at the -- in order to say, well, Madoff says he bought 200 bonds for a client.

Now, I'm looking on -- you know, in his report. He -- he looks on the New York Stock Exchange, and clearly he sees that that doesn't match.

He's ignoring the over-the-counter market. Even though in one of his examples it says the bond trading on the New York, and then it also says OTC market.

But bonds -- that was the price range he was trying to establish in that. There is -- if you spoke to anybody that knew anything -- you know, and I'm not trying to be -- I'm not trying to, you know, be sarcastic with him, but if you spoke to any other person, you know, that -- that understood how the markets work, and you said, I -- I just looked at the New York Stock

Exchange, and he said, well, wait a minute. Nobody trades bonds on the New York Stock Exchange. They trade them in the over-the-counter market.

So, you know, that was to me sort of surprising, that anybody would do that. It -- it demonstrated, you know, a total lack of understanding.

Again, this is not -- I don't want to be unfair to the man. I've had 50 years of experience dealing in things like this, where people who, you know, understand -- I wouldn't understand how lawyers operate.

Okay. So if you asked me how I'm supposed to give a deposition or anything else, I would not know. Of course, now I'm becoming an expert on that also, but it would not be -- I wouldn't -- you know, it wouldn't mean that --

I'm not saying Dubinsky is not a smart guy. He may be a very smart guy. He -- his CV is very good, but I've -- I've dealt with tons of people that are smart people and are experienced people, but, you know, it's like a brain surgeon going to a dentist for -- to have a brain surgery done.

All right. So, to get back to your statement, his -- his lack of understanding how a confirmation in a dealer market works, which is clearly a mistake, or where the volume were traded is another mistake.

He -- he goes on to make another mistake when he talks about the price range. Now, that's a little bit more complicated. Now, all of our transactions are -- are what's called average price transactions.

If you look on the back of my confirmation -- I'm going to take this for a second again -- it states, "Customer equity transactions" -- because this is an equity, being it says -- so it doesn't matter. It would be the same thing with bonds.

It says, "As per your authorization and instructions, we have executed this transaction for your account."

All right. It says, "Unless stated otherwise on the front of this confirmation, the trade price of your transaction is an average price and includes a commission equivalent of four cents per share markup. Full details of this transaction on request."

In other words, an average price transaction is when we buy stock for a customer or, you know, we buy stock. We -- we may start buying the stock on a Monday, and we may buy that Monday, Tuesday, Wednesday, Thursday, Friday. So we may buy a -- 1,000 shares over a period of three days, four days or five days.

We start on a Monday. We may finish on a Friday. That's typically because we're buying a large amount of bonds or stock for a client. And we may start buying the -- let's say, the bond at 98, and then we may wind up paying 100 by the time Friday is, because as the market moves.

So we're accumulating stock, a number of shares or bonds, over an average number of days at an average price.

So if we start buying a bond, let's say, at 98, and we wind up finishing buying it at 100, as the market moves up, we bought stock -- the bonds at 98, 99, 99 and a quarter and so on and so forth.

When we report the trade for the customer on Friday, which is when we're finished, we may have paid 90 -- 99 and three-quarters on the bond. All right. What Dubinsky -- you know,

that was the average that we accumulated for the customer.

Now, the 99 and three-quarters was bought over a period of three days. If -- if you look at -- if he looks at the price, the range of the stock, the price on the day that appears on the confirmation, it may show 100, which was where this -- the closing price was on that day.

All right. But, you know, we may -- we may sell it to the customer at 99 and three-quarters, which was the average price of that stock. He -- he thinks that that's a mistake.

How could we have bought the stock for the customer at 99 and three-quarters, when it shows that -- it shows that the cheapest price the stock traded was 100.

So he's saying that Madoff is -- is buying stock cheaper than he could have bought it in the marketplace. He's not accounting for the fact that we started buying it, you know, three days.

In other words, it wasn't -- he thinks it was all bought at one price on that day. Okay. If he -- if he bothered to read the back

of the confirmation, which he probably never did, you know, it clearly states that these are average price transactions. They're not one price.

Okay? We're --

MR. SHEEHAN: I just have a little housekeeping.

MS. CHAITMAN: Yeah.

MR. SHEEHAN: I'd like -- he read from that. I'd like to get that marked. That.

MS. CHAITMAN: This -- this marked.

MR. GOLDMAN: The photocopy.

MR. SHEEHAN: And his notes too. He's reading from notes.

THE WITNESS: This is just --

MS. CHAITMAN: That page. Okay. Good. Okay. So I'm going to mark as Exhibit 9, this is a page from the volume that we've just described. It's page 323.

MR. SHEEHAN: Great. And I think he had his notes that he was reading from too. So --

MS. CHAITMAN: Did you have notes that you were reading from?

MR. SHEEHAN: Yeah.

MR. GOLDMAN: Yeah, there was.
THE WITNESS: Where did I put them?
MS. CHAITMAN: Were there -- I did mark notes before. Are there new notes? I didn't notice.
MR. SHEEHAN: Yeah, there were notes that were part of the --
THE WITNESS: Here they are.
MS. CHAITMAN: Okay.
MR. GOLDMAN: There they are.
MS. CHAITMAN: Can I mark that?
THE WITNESS: You can have it, but it's my only copy. Okay. I am not finished with it yet. So don't -- don't take it.
MS. CHAITMAN: No. I'm not taking it.
(MADOFF EXHIBIT 9 WAS MARKED FOR IDENTIFICATION.)
MS. CHAITMAN: I'm going to mark as Exhibit 10 some handwritten notes that Mr. Madoff has been referring to, and I'm going to give it back to Mr. Madoff.
(MADOFF EXHIBIT 10 WAS MARKED FOR IDENTIFICATION.)
MR. SHEEHAN: For the record, there's notes on the back of that page too.

MS. CHAITMAN: Yeah, yeah.
MR. SHEEHAN: That'll be fine.
MS. CHAITMAN: But it's all one exhibit.
MR. SHEEHAN: Yes. It is one exhibit.
MS. CHAITMAN: Yeah.
THE WITNESS: Okay. So --
BY MS. CHAITMAN:
Q. So let -- just to catch up. One mistake he made was not understanding that on the trade confirmations it -- Madoff -- the firm is buying -- if it says, "bought," it means Madoff, the firm, bought?
A. It means that -- it means -- yes. The, "we," refers to the firm, Madoff, bought from the customer or sold to the customer.
Q. To the customer. Okay. And -- and sold from the firm's own inventory?
A. That's correct.
Q. Okay. And then you've made the point that Dubinsky looked for confirmation of the volume on the New York Stock Exchange or the London Stock Exchange, and, in fact, the convertible bonds were not sold on the -- you didn't buy them on the --
A. We traded in the over-the-counter market.
Q. Right.

A. And there was not even volume reported -- in the days -- the period of time he's looking for there was no volume -- actually, the majority of the volume was never reported in the over-the-counter market, because there was no volume requirements to report volume in bonds in the over-the-counter market until a later date.
Q. Okay. Do you --
A. It was very -- it was a very -- I don't -- it was very hazy, the -- the volume reporting requirements on -- on bond -- in the bond market was never really -- it was that way -- to this day it's sort of a gray area.
Q. Okay. All right. Now -- now you want to go -- do you have another area that you want to cover?
A. We've covered the confirmations and the statements, and we've covered the volume, and we've covered the price. So basically what I'm saying is his -- his criticism of the price of the volume and of the confirmations and statements are inaccurate.
Q. Now, Mr. Dubinsky says that there's no proof that the bonds were converted.
A. Okay. A -- the -- the typical strategy on convertible bonds is not to convert. In other words, nobody in their right mind should ever -- if a

convertible bond exists, you would never buy the stock, as opposed to buying the bond, if you could buy the bond at a discount.

In other words, a convertible bond trade -- a convertible bond -- let's say a bond is convertible into 100 shares of stock at $10 a share. All right. The -- the convertible bond always should trade at a premium above what it's convertible into the price of the stock at, because it has a coupon attached. It pays interest.

So convertible bonds typically trade at a premium. In other words, the bond theoretically would be worth 100 based upon the price of the stock at ten. The bond should always trade above 100.

It should trade at 101, 100 and a half and so on, because of the fact that the convertible bond is always -- is always going to be worth more than the stock, you know, because of the coupon that it has to it.

So convertible bonds sometimes trade at a discount, but rarely. Usually they trade at a premium. All right. When you combine a bond at -- a convertible bond at a -- at a discount, you could theoretically buy the bond, let's say, at 98, when it really should be selling at 100.

All right. Because you could buy the bond at 98. Sell the stock at ten. Would be -- you'd make a two point profit by converting it. So ideally you would say, okay. If you -- because then you'd have no risk.

You'd immediately buy the bond at a discount, sell the common stock simultaneously at a profit, and then convert one into the other. You exchange the bond by selling -- sending it to the conversion agent and say, here is your bond back. You know, I want stock back. And then you'd deliver the stock out, and you'd make a profit.

But most bonds trade at premiums, which is what they shouldn't be doing. All right. So the typical strategy of a convertible bond trader would be to -- to buy the bond either at a discount, which allows you to convert it immediately and make a profit, or hold the bond open and wait for the bond to go to a premium, where it historically should trade at, and then you sell out the bond, cover the stock and un -- what's called unwinding the transaction.

Which Dubinsky in his report does state that that is one of the -- he has that right. That that is the -- you do that kind of trading, you know, either buying it and converting it or unwinding the

transaction. He acknowledges -- he has that -- that part right.

He doesn't go into the fact that most bonds should not be converted, but anybody that is familiar with convertible bond trading would know that.

All right. The -- so what Dubinsky then does is he says that Madoff, you know, who -- who did buy bonds at a discount and sell the stock, you know, accordingly, it had a locked-in profit, he never physically converted -- he never sent the bonds in to be converted, you know, and take the profit that way, which he should have -- he should have done, you know.

But he said, there's no evidence that he ever put the bonds into conversion, because typically he would have found in our records, he assumes, some sort of instructions to the conversion agent to convert the bonds into stock.

All right. And if, in fact, we did that, he would -- he would find those instructions, but our strategy, as he acknowledges, as most people's strategy would be, to -- to not convert. He doesn't, you know, really go into the details of that.

So our strategy is basically buy the bond, sell the stock. And even though we have a profit and could convert it and lock in the profit, is we don't

convert it. We hold it open, and then we undo the whole transaction when the premium goes back to where it should be.

As a matter of fact, when David Kugel was first hired by me his job was to track all of the convertible bonds that traded in the marketplace. And we had a -- a whole spreadsheet that -- that we developed for him that tracked what every bond that was trading in the marketplace historically traded at.

So it would look and see that -- let's say IBM bonds traded over this past two years always went to a two point premium. It always traded at a two point premium.

You know, every now and then it -- it would go to a -- a discount or a one point premium, and then, you know, it would go back to that premium. So we would track them historically.

And we would always look to see when the bond was -- you know, was changing its relationship. And then we would go into the marketplace and buy those bonds. And that's what all convertible bonds traded, but that was our specialty, was trading this way.

All right. But anybody that was a good convertible bond trader did the same thing. It was

not unique to us. We happened to do more of it than most people.

All right. So our goal was to not convert. It was -- it was basically to unwind the transaction. All right. So because he -- he could never see that we were actually converting, and -- and he did find some that we converted, but not -- you know, but there were instances -- he made the assumption that we would always convert, and that -- that's totally untrue.

All right. Because what we would do would be when -- when the premium went to where we expected it to go to, we would, what's known as, unwind it or swap the transaction, which another dealer that had the transaction.

The problem -- the customer would make -- he could make more money theoretically, you know, within what we -- than what he made had we actually converted it. He could make a greater profit or he could make the same profit. It didn't matter.

But as a dealer our goal was to keep bonds out of conversion, because the more you kept the bonds out of conversion, you kept them open in the marketplace to trade at a -- at a future time.

So -- because once you convert a bond it's out of existence any longer. So the goal of all

traders is to keep these bonds in circulation. So you could --

It would be like if a customer -- if everybody took the stock that they bought, and they -- and they -- the company bought back more of their stock, when a company, like IBM, buys back their stock in the marketplace, they're taking it out of existence anymore. Nobody can trade that stock. So everybody wants to keep these bonds in circulation.

All right. Now, another mistake that he makes is if, in fact, we did convert -- you know, he makes the assumption that we would physically put the bonds ourselves into conversion, which, you know, I can understand him thinking that we would do that.

All right. But he makes the assumption that because he didn't see any instructions from Madoff to the conversion agent, that we didn't convert.

What he seems to not understand, which I can understand him not understanding, is we had -- he thinks our only bank was J.P. Morgan and Bank of New York, which -- in the 2000's those were our main banks.

J.P. Morgan was our primary bank when we were dealing with customers in split-strike, and our operating bank when we were dealing with our

market-making and dealer in -- in general, doing hundreds of thousands of trades, were handled through Bank of New York, which was our operating bank.

All right. In the period that he's looking at the convertible bonds in the '70s and the '80s, we had -- our banks were Chase Manhattan Bank, Continental Bank, Commercial Bank of North America, Meadowbrook National Bank, Marine Midland Bank.

You know, we also had clearing arrangements with -- with Barclays, with Carlo LaBorde (PHONETIC) & Company, Edwards & Hanley (PHONETIC) and others. In other words --

Q. Bear Stearns?

A. Huh?

Q. Bear Stearns?

A. Bear Stearns. So he like -- he doesn't see any of that, because he wouldn't. He's looking at -- you know, in the -- in the more recent period those banks have already been merged out or don't exist any longer.

You know, when we -- when we did convert bonds -- and we did convert bonds, you know. We didn't -- you know, the -- the majority of what we unwound, but we looked -- when we did convert a bond, we would convert the bond through one of those agents,

like Commercial Bank of North America, because if the bank's conversion agent was in Chicago, and we wanted to convert it, we would have -- we would have had to either send somebody out to Chicago or a messenger to convert the bond or mail it and hope that the mail -- the bonds actually got there.

You would never do that. You would -- you would give it to a bank, you know, and the bank would convert it for you. So we would give it to the Commercial Bank of North America.

They had -- they were a large clearing bank, and they would physically convert it with arrangements through whoever the conversion agent was doing that.

All right. He doesn't -- he has no way of knowing that, because those banks weren't -- he doesn't even know those banks existed when they were there. So the banks themselves, which we would convert, would -- would draft out.

It was the same thing like when we would deliver -- before we formed the clearing corporation on equities, if you sold stock to a brokerage firm in Chicago, in order to get paid for that you would have to mail that stock to Chicago and hope that they sent you a check while the bank -- you know, when they finally got it.

All right. As opposed to when we developed a clearing corporation, meaning the National Securities Clearing -- Clearing Corporation, NTTC, you know, we would -- they would clear the whole transaction.

So it would -- you know, of course, the industry -- another thing I got blamed for was founding the clearing corporation, because Wall Street cleared all of their transactions through basically a couple of major banks, like Citicorp, Chase and so on.

Nobody -- they handled -- they -- brokerage firms themselves didn't all have the facilities -- back office facility. So a bank used to clear those trades for them. The banks -- that was a great business for banks.

So the industry, because of the paperwork crisis, decided they had to have a -- they had to have a clearing corporation developed to clear the trades for the industry.

The major banks in the United States went crazy with that concept, because they wanted to keep all of the business themselves. They wanted brokerage firms to be required to -- to use the banks to clear the transactions rather than have a clearing corporation.

But finally we -- you know, the SEC put enough pressure on people to develop a clearing corporation. So we formed the National Securities Clearing Corporation, which I became the chairman of.

And then we merged also Depository Trust into that. So that brokerage firms would send their deliveries of stocks rather than through the mail, where you have to use the bank to do that, to use a clearing corporation, which settled all of the trades for the whole industry.

So what -- what happens today -- I'm telling you more than you probably are interested or wanting to know, but if I -- I may buy stock -- you know, sell 10,000 shares to Merrill Lynch and 10,000 shares to someone else and so on and so forth.

And buy and sell all day long with -- you know, like we did hundreds of thousands of transactions as -- as the report points out. The clearing corporation nets all of these transactions, you know, among the Wall Street brokerage firms.

And at the end of the day they net out -- I may have bought and sold a million shares during the day, but the net comes out to 500 shares between all my buys and sells.

They send me a bill at the end of the day

that I either have to pay on the 500 shares or get a check for the 500 shares of stock. And all of the banks went out of the clearing business, and now it's all handled by the National Securities Clearing Corporation Depository Trust.

Q. Okay. I want to go back, because that's one of the things that Dubinsky talks about, that he can't find trade confirmations. Now, we're dealing with --

A. So --

Q. -- the convertible arbitrage strategy -- strategy in the 1980s.

THE COURT REPORTER: Can I ask for a break?

MS. CHAITMAN: Of course. Of course.

THE VIDEOGRAPHER: Going off the record. The time is 12:09.

(RECESS FROM 12:09 P.M. TO 12:16 P.M.)

THE VIDEOGRAPHER: Back on the record. The time is 12:16.

THE WITNESS: Okay. So I think we were at the -- the clearing of -- oh, so that his inability to find instructions to convert bonds, you know, all the time was that he was not aware of the fact that if we did convert bonds we had the ability and did convert bonds through other

clearing -- other clearing banks.
BY MS. CHAITMAN:
Q. So that you wouldn't have the records for that?
A. Wouldn't -- they would not exist, because there would be no way that we would put the bonds physically for the most part -- we did some -- some of them, depending upon what the year it was and what he was looking for, but, as I say, the idea was not to -- to actually convert, but --
Q. Right.
A. -- to arrange a swap arrangement --
Q. Right.
A. -- or a clearing arrangement.
Q. Okay. Now, he also makes the point that he couldn't find trade confirmations.
A. Okay. That -- when -- one of the times that -- when you first came down, if you still remember --
Q. And when you say, "you," are you --
A. Meaning David Sheehan --
Q. Sheehan.
A. -- and his staff of attorneys came down here. I think it was at that time that they mentioned to me that they could not find confirmations --

counterparty confirmations on transactions.

So -- and we were buying and selling stock through other brokerage firms for clients. They expected us to -- they saw that we had confirmations selling and buying stocks from the customer, but they did not find any confirmations to the broker.

All right. Now, number one, if we were dealing as principal, which clearly our confirmations stated, and we always did it as principal, we would -- there wouldn't be a counterparty on the other side of the trade, because we were the counterparty on the other side of the trade.

But when we did go out into the street to buy the stock, you know, there would be a counterparty, you know, on the other side of the trade. He couldn't find the confirmation. So he saw thousands of confirmations with clients, but he never saw any broker confirmations, period.

So he said to the -- you weren't buying and selling stock from anywhere. You know, there were no confirmations. And I looked at him, and I said, well, no. You know, I was sort of -- didn't understand the question, because I didn't understand why he expected there to find confirmations.

Q. When you say, "him," to whom are you

referring?
A. The trustee.
Q. Okay.
A. And -- so it was that -- you know, I then realized that, you know, he expected to find -- you know, just as he found a broker confirmation, he assumed that every time we went and sold or bought stock from a customer we bought it from another broker, which sometimes we did.
Sometimes we bought it out of inventory. If it was bought out of inventory, there wouldn't be -- there would be a customer confirmation at an earlier date that -- that we put it into our inventory, but --
All right. But, I said, there -- there are no confirmations. And that sort of went on deaf ears. Now, number one, I said, first of all, you're looking at -- we don't -- we don't keep any records of customer confirmations from the past six years.
I said, the record retention period for the industry is six years. So after six years everybody gets rid of all of their records. You can imagine, we do hundreds of thousands of trades everyday.
If we -- if we kept paperwork for all of those transactions, you know, it would be impossible. I said, so we keep customer confirmations for, you

know, a longer period of time, because customers need that for tax purposes, audits and so on and so forth.

But a general policy, we don't keep records for more than six years, because that's what the record retention period does. Even though we did have records, because -- and I used to always yell at my people.

I used to say, after six years, get rid of everything, because I'm paying for storage on this stuff. But I said, wait a minute. I said, you won't -- you won't find confirmations for any of my trades.

I said, I do hundreds of thousands of shares -- of trades everyday. I said, you don't find -- you can't find any of those confirmations. I said, so are you now assuming because you can't find a confirmation when my market-makers or proprietary traders bought hundreds of thousands of trades everyday that those trades didn't take place either?

And there was no answer. I said, first of all, are you aware of the fact that brokers stopped issuing confirmations years ago?

Q. How --

A. Because of the clearing corporation.

Q. How many years ago?

A. Well, there's what's called a continuous net settlement, which I started to say. In other words, when we buy and sell stock all day long, anybody buys and sell stocks when they're long, they don't issue a counterparty confirmation to Merrill Lynch, because those trades are reported automatically through the clearinghouse, and you get -- you don't get confirmations.

Customers get -- confirmations get mailed out back and forth, but the industry does not issue confirmations to each other, you know, as a general rule. You can, if you want, but nobody would do that.

So I said, so making your supposition that you can't find a confirmation from a brokerage firm on the other side of a customer trade, and you can't find -- you won't find a confirmation on the other side of a - of a non-customer trade either, because they don't -- I don't have any customer confirmations in my records.

I said, how can you not understand that? Now, maybe -- like my lawyers -- you can't expect him to understand. They're lawyers. They're not brokerage firms.

I said, all right, but you're asking me questions -- you know, they're asking me questions

that they have to get somebody that explains that.

Now, certainly Dubinsky would know that, but he doesn't even mention -- in fairness to Dubinsky, he doesn't -- he doesn't mention anything about this confirmation issue, because he clearly knows that much.

This was the trustee, Irving Picard, and his attorneys, or, I guess, and David's partners or whatever. And maybe they had no reason to know that either, because the average person would not know that.

Q. When did the continuous net settlement system come into place? Was it in place in the '80s?
A. Yes. Probably in the '80s.
Q. Okay.
A. So --
Q. So how -- how does that work? At the end of the day you just get a computerized printout --
A. Right.
Q. -- with -- with the net amount that you have to sell --
A. Right.
Q. -- or receive?
A. Right.
Q. Okay. Okay. And if you were doing

over-the-counter purchases and sales of subordinated bonds, convertible bonds --

A. Yeah.

Q. -- was that done on a continuous net settlement basis also?

A. No.

Q. How was that done?

A. It was just -- it was -- you wouldn't issue a confirmation. It was -- well, it depends -- you want to know about a convertible bond for a -- for a claim?

Q. When you were doing the investment -- I'm focusing on the 1980s.

A. Right.

Q. The convertible arbitrage transactions.

A. Uh-huh. We wouldn't have -- there wouldn't be -- it -- we would issue, you know, a -- we would issue a confirmation there, but we wouldn't have those in our records in the '80s, because we don't hold the confirmations after six years.

Q. Right. And the -- if you were -- you were selling to the customer, you had a confirmation, but when you were buying it --

A. There wouldn't be a confirmation.

Q. -- for inventory, there wouldn't be a

confirmation?
A. No. Not -- not after six years.
Q. Okay. Okay. So we're -- we're going -- we started out listing the mistakes that you felt --
A. Right.
Q. -- Dubinsky made. Did he make a mistake with respect to using the trade date versus the settlement date; is that what you covered already?
A. The average price. Yes.
Q. Okay.
A. On the ranges?
Q. Yeah.
A. Well, it's -- if you look at the range on -- you wouldn't have -- there wouldn't be a -- there wouldn't be a record of the ranges.
Well, first of all, you can't even use the ranges, because you'd have to -- well, he -- in order to -- in order -- in other words, if the SEC was doing an audit, which they did all of the time as to, you know, best -- what's called best execution, they would actually look and see, you know, what dates you bought this stock.
Okay. You know, if it was an average price transaction, they would have to go back and look at all of the days, you know, that you accumulated the

stock, not just use the last day that you reported the trade to the customer, because they understand what an average price is.

Now, the only ones -- typically if you call up a broker, and you tell him, buy me, you know, 50 shares of IBM or 200 shares of IBM, they would actually -- they wouldn't do that over the course of a day.

All right. Because that -- you know, they would just buy -- it's a small amount of a lot, but if you're dealing with -- with discretionary accounts or you're accumulating a larger -- with a -- a portfolio of accounts, the way we always traded, you would always do an average price transaction.

So they -- what they would have to do is go back, which they would do, and see what was your real average price. They would verify what the average price was, not just look at the last day, because they would realize that you would never be able to find a -- you would rarely be able to find a match, because you'd --

Q. Right.

A. -- have done it, you know, at different periods of time.

Q. Right, right. Are there other general

mistakes that you can recall from --
A. Well, we -- he mentions that David -- well, he talks about David Kugel as -- you know, he mentions in the report that David Kugel -- in other words, he acknowledges that they don't have records going back to the time that David -- he's talking about David Kugel, because we don't -- there are no records.
So he's -- he points out as a footnote that he's using David Kugel's information to plea bargain that he created fictitious trades. Now, as I stated before, that makes no sense to me at all.
And I think that David Kugel -- I'm not even -- I'm not saying that he's lying. I'm saying that he misinterpreted -- what he said when he created a trade, he's misinterpreting what he's saying.
In other words, if -- if -- if I -- if I give instructions to -- you know, if I wanted -- if I decide I want to sell stock to a customer out of my inventory, I -- I could say to someone like David Kugel, you know, I want to sell stock to -- I want to sell, you know, IBM to the client.
So we have 100 bonds in -- 100 convertible bonds in the account. I want to sell to Carl Shapiro, you know, 20 bonds. You know, I want to do a convertible trade for him.

Give instructions, you know, to Annette to buy, you know, convertible bond, you know, for -- for Carl Shapiro, and, you know, just tell her what -- tell them what the formula -- what the formula is, so she knows how many bonds -- how to set the trade up.

He -- you know, he would write these instruction sheet -- this -- this convertible bond, you've got to -- if you're going to do 50 bonds, you know, this is -- this is how many bonds, and this is how much stock you sell.

And it gives her like -- she then looks at my inventory record and sees, okay. He -- he has X number of bonds he can convert. Takes it out of -- out of the investment account or the firm's trading account into this customer account.

So David Kugel has no idea, nor has any other trader, what the -- what the firm's net inventory. We could have -- we could have -- we have five different traders trading IBM convert. They're all competing with each other.

They don't want to -- they never want David to know what his position is, because he -- you know, they're competing with him. That's part of the strategy of the firm, all market-making firms.

So he -- if -- if -- if someone says, well,

give them instructions, he'll give -- he'll give Annette or Jodi instructions of how many bonds to -- to buy and sell for this customer.

He has no idea after that where that -- where it's coming from. He doesn't know whether it's coming from the firm's inventory, from his inventory or someone else's inventory. He would not know that.

So if -- if he says to somebody, which is a very -- I'm going back to like when I told in my proffer agreement that I short stock to a customer. And they said, you sold stock to a customer? How can you short stock a customer? You're selling them stock that you don't own.

And I say, yeah, market-makers do that all day long. That's part of our business. We're shorting stock to a customer. And he -- and an alarm bell goes off and says, well, how can you sell stock to a customer you don't own?

Q. Okay. Well, that --
A. You know --
Q. Let me ask you that.
A. Okay.
Q. Was that illegal, for you to be selling stock to a customer that you didn't own?
A. No. I'll -- I'll -- I'll explain that too,

because that's -- that's another issue, but let me just finish this thing.

So that if, in fact, David Kugel or anybody is -- is giving instructions to the operations side of the business, meaning Annette or Jodi, of -- of how to do a trade, that doesn't mean that's a fictitious trade.

He -- you know, he has no idea. He's just telling her how to do the allocation of the trade. Not -- he doesn't know if -- you know, whether or not the firm has it in inventory or doesn't have it in inventory.

But even if I wanted to short it to the customer, let's say I didn't have it in inventory, there's nothing wrong with that. I am allowed to short stock to a customer.

Theoretically I could have shorted all of these split-strike trades to the customer forever. My violation was not going short. It was not recording the short on my financial records as a liability, which I guarantee you, nobody understands that.

To this day if I called up the prosecutor, Litt, and I said to him, you know, I don't have -- there's nothing wrong with me shorting stock. He would look at me and say, that's not true. You can't

short to a customer.

And I can prove that to you, because I don't know how many times, you know, I had to -- I had to argue this case in front of the SEC and with the issuing companies, like Apple computer and everything at -- when we were at board meetings with the IBM.

Average company does not want you to ever short stock. In other words, every company that trades on an exchange does not want a brokerage firm to sell stock that he doesn't own.

They think that short selling is illegal, is immoral and should never be done. All right. That's what they want. They don't want ever -- they don't want anybody to be able to short stock.

Just like nobody wanted, you know, George Soros to short Sterling and make a billion dollars shorting -- you know, breaking the market on -- on shorting.

But what they don't understand is that shorting is a very -- you know, a very, you know, legitimate market, you know, thing to do in the marketplace, and it's required, because it keeps stocks from going to artificially high prices.

All right. And the -- it certainly happens that as I was -- when I was looking for -- reading

another book, one of the things I do here is I tutor people on finance and the marketplace.

Of course, the Bureau of Prisons only big concern is that I'm teaching them a fraud. All right. So originally I was told, no, you can't tutor or teach anybody here, you know, but I said, listen, I said, they -- you have outside people coming in here, professors, to -- to lecture, you know, as part of, you know, the justice department, and they're all asking, can Bernie Madoff -- you have Bernie Madoff sitting here. Let him lecture people.

And the Bureau of Prisons says, the newspapers are going to say that Bernie Madoff is -- is perpetuating a fraud. Just like when they put me in charge -- when I first got here, my first job was in the engraving department.

I was engraving signs, you know, that they hung on walls here. So the -- the Wall Street Journal said, Bernie's first job is engraving, you know. So they said, take him away from the engraving department.

And they -- I had seven jobs in seven days, because no matter what I was doing, including I was in charge of cleaning the computers, you know, can't do that, you know, because you're reprogramming the

computer.

I couldn't reprogram my telephone number. You know, that's not my -- not my strengths here. So I'm now -- my job is now cleaning the laundry room. That's my job here.

The -- I'll -- I'll -- there's a book that was written by someone like Dubinsky. He has a very big -- and he talks about --

MR. GOLDMAN: Tell us the name of the book and the author, Bernie.

THE WITNESS: I don't even know what it --

MS. CHAITMAN: May I mark that whole thing as --

THE WITNESS: "Secret Weapon."

MS. CHAITMAN: -- the next exhibit?

MR. SHEEHAN: Could you just mark it as an exhibit?

MS. CHAITMAN: Yeah. Let me just mark it.

Can I mark this whole thing?

THE WITNESS: Yeah.

MS. CHAITMAN: Is it all connected?

THE WITNESS: Yeah.

MS. CHAITMAN: Is it all one --

THE WITNESS: Yeah, yeah.
MS. CHAITMAN: Okay.
THE WITNESS: Anyhow --
MS. CHAITMAN: So I'm marking as Exhibit 11 --
(MADOFF EXHIBIT 11 WAS MARKED FOR IDENTIFICATION.)
BY MS. CHAITMAN:
Q. -- a -- it says the author is Kevin Freeman, and the title is, "Secret Weapon." And it's pages -- I don't know what the first page is, but the --
MR. SHEEHAN: It's the inside cover.
Q. The inside cover is 78. 78 to 83, and then 123 and 124.
A. He's talking about how the markets work. He talks about bear runs, and he talks about naked short selling, and he talks about the Madoff exemption.
Q. Is that a term that's in the industry?
A. Naked -- yeah, naked --
Q. No, but the Madoff exemption?
A. Yes. In other words, he goes on to state, "Long before he was convicted of defrauding the American public of some 50 billion through a Ponzi scheme, Bernie Madoff was chairman of the National Association of Securities Dealers, NASD. In that

capacity he appeared regularly at the SEC and served on agency panels."

And then he quotes them as saying, "When it came to Bernie, people paid more attention, said Georgetown University law school professor, Donald Langevoort, who worked on an SEC panel with Madoff."

He quoted -- then goes on to quote, saying, "This was a guy who really knew how markets worked. He was the grownup in the room. If there was a confession" -- "if there was confusion or a question or two people on opposite sides going at each other, Bernie would speak up and explain what the deal was. I'm sure in some ways that may have thrown even the commission off their guard."

"One of Madoff's key accomplishments at the SEC was to get a rule approved, the so-called Madoff exemption, that allowed market-makers to naked short sell. Market-makers are broker-dealer firms that gain fees by holding shares of securities in order to help grease the wheels of trading."

"If someone buys stock in a company, it is the market-maker who sells the stock and then finds an offsetting order. This keeps the markets flowing smoothly."

"In the case of short selling if the

market-maker has no inventory of the shares sold, the firm is allowed to create an IOU for the shares. This is a form of naked short selling legalized by the Madoff market exemption."

Basically what he's stating, this is the -- he's quoting this law professor at Georgetown, who served on a panel with me, that says that I could sell stock short.

So selling stock short, not only is it something that is to the benefit of the marketplace, market-makers are required to sell stock short. So theoretically I don't ever have to, you know, buy stock for a customer.

I'm responsible for producing that stock if the customer ever wants it. And any profit that the customer makes in the trade I'm responsible for.

So in theory, which my attorney said to me, Bernie, you know, you can -- you're not doing anything wrong with being short these split-strike trades to the client, you know. You know, I can short all day long, and I do short stock at times. Every brokerage firm short stocks to a customer.

My violation was not showing the IOU, the liability, you know, on my balance sheet. That's what the violation was. I would have also been out of

ratio, you know, by not -- if I did show that. So --
Q. So you mean that there was -- do you -- if you sell short, do you have an obligation -- is it your understanding that you have an obligation to the customer?
A. To produce that stock if the customer wants it.
Q. Right, but do you have an obligation -- and we're talking about the investment advisory customer.
A. Yes.
Q. Did you have an obligation to tell the customer, your statement shows 30 shares of IBM, but I'm actually short that --
A. No.
Q. -- position?
A. No.
Q. So it was --
A. No. You don't -- you're not --
Q. So if -- if a customer is -- if a securities customer is dealing with a market-maker --
A. Or anybody.
Q. Well, only the market-makers have the exemption.
A. No, no. That's -- that's wrong. The market -- the -- the -- anybody can sell stock short

to a customer, you know. The -- it's -- they always can sell stock through shorting, but he --

You know, what he's talking about is -- you know, is that, you know, I was the one that argued for the short stock selling, because what he -- he confuses the situation, because there are certain requirements that a market -- if a market-maker is shorting stock to a customer or to anybody, he has to -- his records have to show that he shorted the stock.

MR. SHEEHAN: Who is, "he"?

THE WITNESS: Meaning the brokerage firm.

MR. SHEEHAN: Okay.

BY MS. CHAITMAN:

Q. Okay. So the brokerage -- so let's just take the split-strike. Okay?

MR. GOLDMAN: Wait. Before -- before you ask the question, I think he said -- and the transcript will speak for itself, obviously, but I think he said that the -- the market-maker was required to sell short. Did you mean permitted to sell short?

THE WITNESS: Well, you -- you're required to make a two-sided market. So if, in

fact, you -- you're not required to sell stock to the customer short. You're allowed to sell stock to a customer short.

MR. GOLDMAN: That's --

THE WITNESS: If -- in other words, that's the difference. You have to be -- you have to sell it at a price that's related to the marketplace, you know.

And you have to -- you -- you -- you would put it on your records that you're selling short on the original order ticket. You have to mark it, because it's what they call an uptake rule and so on, which means you have to -- it's not important. It's confusing.

BY MS. CHAITMAN:

Q. Okay. So -- so basically if you take John Smith. He's a split-strike customer. His statement shows that he owns a portfolio of securities, and, in fact, you don't at that time own them.

A. No.

Q. Are you saying that there's nothing fraudulent about issuing a statement to an IA customer --

A. Uh-huh.

Q. -- an investment advisory customer, showing

securities as having been purchased for the customer, when, in fact, they haven't been purchased?

A. That's correct.

MR. SHEEHAN: Object.

THE WITNESS: You don't have to -- you're not required. It's not the customer's business whether or not you're selling the stock from long or whether you're selling it short.

BY MS. CHAITMAN:

Q. Okay. So what you're saying is that the fact that the split-strike conversion strategy was carried out from sometime in 1992 until December of 2008 without your actually owning the securities that showed up on the statements, that was not a fraud, but the fraud was that you didn't disclose to the SEC on your focus reports --

A. That's correct.

Q. -- that you had that debt?

A. Right.

MR. SHEEHAN: Objection. Objection, but go ahead.

THE WITNESS: That's correct.

BY MS. CHAITMAN:

Q. Okay. Can you put this in your own words, so we don't have any confusion about it? I just want

it to be very clear on the record.
A. That there is nothing wrong with selling stock to a customer out of a short position. In other words, you do not have -- that is not a violation. The violation -- and it is typical for a brokerage firm to at times sell stock to a customer short. That is not a violation itself.
And the customer doesn't care whether the stock that you are selling him is stock that you actually are long or short. You know, the customer assumes, as -- and, rightfully so, that if he wants -- if wants delivery of those securities, or he wants the profit made from the transaction, that you're still obligated to do that.
So had I reported this transaction on my financial records as a liability, that would be -- that would be all right, but because I didn't, that's where the violation was.
Now, obviously, I couldn't do that, because my -- my liabilities would have been too great. Which brings me to another error, you know, that I find in the Dubinsky report. See if I can remember where it was. Related to that. The -- well --
Q. Do you -- do you want -- do you want her to read back your last comment? Maybe it'll prompt you

to --
A. No.
Q. -- to recall.
A. No. I'll think of it. First of all, here is this. This is yours, and this is yours, I think. I have too much paperwork here.
Q. I just want to go back -- back to this. Forgive me, but it intrigues me.
So the entire portfolio that was purportedly owned by the investment advisory customers from 19 -- from whenever it was in 1992 that you stopped buying the securities that showed up on the statements until 2008, you had always honored withdrawals?
A. Right.
Q. You never defaulted in any of your obligations to the customers?
A. Not until, you know, I went out of business.
Q. Right. Okay. So the only violation of law that you understand you committed was not disclosing on your focus reports that you had sold short; is that right?
A. Not that I had sold short. That I didn't -- I did not reflect my liabilities. That was because of the short position.
Q. Right.

A. The short position would have reflected a liability to the customer.
Q. To purchase the shares?
A. I did not show that.
Q. Okay. Okay. And I just want to ask you one other thing, which is not related, except it came into my mind.
A. Okay. Before you do that --
Q. Oh, okay.
A. -- I remembered what I was going to say.
Q. Go ahead.
A. Dubinsky states that -- well, he -- he -- he acknowledges that he -- he doesn't have records to prove this, but he infers in some language that because I did not on my focus reports --
One of the -- one of the things that he -- points he makes to demonstrate that I was -- he was trying to establish his theory, obviously, initiated by the trustee, that my fraud went back almost to the beginning of time.
All right. That I didn't do any business, because I did not reflect any customer business on my financials -- on my focus reports. Customers that were -- you know, activity, long and shorts.
So -- because he says that, you know, I

mean, he -- he's saying he could have been doing business in -- for customers in the '80s or '70s or '60s, the '70s even, because my focus reports, which he doesn't have, by the way, because he doesn't -- he can't get that, but he's assuming that there was no customer, you know, business -- no customer positions shown on my focus reports.

All right. But this is a common error made in -- by customers in general. I used to get calls from people that would say, listen, Merrill Lynch doesn't show, you know, my assets on a position.

He's doing all of this business with -- with me or with all of these customers, and it doesn't show on Merrill Lynch's financial statements, you know, any of this business.

I said, well, are you talking about his balance sheet? He says, yeah. I said, brokerage firms do not show customer assets fully paid for securities on their balance sheets. Otherwise, Merrill Lynch would have trillions and trillions of dollars.

I said, you know, when a brokerage firm files a focus report or any balance sheet, when they send you, you know, they do not -- they do not show or record customers' fully paid for securities.

So if a customer had a margin account or a -- you know, a liability, he would have to show a payable or a receivable from a customer.

But if a customer buys IBM, pays for the IBM, and the brokerage firm has that IBM in his -- you know, in his box or at the clearing corporation, that doesn't appear on his records anywhere. So, you know, as long -- if I was -- if I had a -- a liability, and not from a short sale, because, you know, the short sale -- the short sale, if it's a liability, would appear on it, but if he was long and short, the same -- it's another thing.

When you're trading in convertible securities, you're -- you're allowed to net the -- the receivable and payable for the same customer against each other. So that stuff does not appear on a focus report.

Now, that's a basic accounting. Anybody that's a -- anybody that's familiar with any brokerage firm accounting would know that question. So why he would think there would be a -- that would be on my -- on my balance sheet, it's not certain.

What would be on my balance sheet would be if the customer owed me money, which is another thing. There's a -- there's a major flaw. And this I have to

address, even though you didn't ask me about it.

The trustee somehow or other when I read the GAO report -- and I actually spoke to the treasury secretary -- the inspector general of the treasury department about this.

In the -- in the -- in the GAO report, issued by the government, which is a report that he issues from the general accounting -- accountability office, based upon the trustee's report, there's a --

I have a -- this is something that -- David, you might ask Irving Picard how he had managed to get this thing slipped through.

Jeffry Picower --

MR. GOLDMAN: Tell us what you're looking at, Bernie.

THE WITNESS: Oh, this is the GA -- a copy -- part of the G -- the SIPC report, the GAO report, which is -- took seven years to -- to finally get, which my attorneys assured me was going to be done immediately. It took seven years to finally get them to do the results of -- of the trustee's report.

There's a 6.3 billion dollar liability to the debit balance in Jeffrey Picower's account, which was a -- a major issue was one of

the things that created my whole problem. This relates to them -- them not honoring their commitments with me when -- and --

Okay. This is on -- and I can't give you -- this is my only copy, but you can find it. It's on page 37 of the -- of the GAO report.

And I'm quoting now the General Account -- Accounting Office. It says, "As part of our review of the records provided by the trustee, we noted some customer accounts having a negative balance."

"For example, in the Picower case the records showed a negative balance of 6.3 billion dollars. In theory this reflected some kind of margin account or debit balance."

"The trustee told us even though such an account would not be in keeping with the standard industry practice, such negative balances raised the question of whether the reported amounts represent a debt owed by the customers to the Madoff firm."

Now, that clearly is a debt. All right. Jeffry Picower owed me 6.3 billion dollars. All right. The trustee -- I mean, the GAO -- thank God. He questioned the trustee,

what about the 6.3 billion dollars?

And for some reason the trustee claimed, well, we can ignore that, you know. That's not typical.

All right. Now, if you look at my records or any brokerage firm's records or account agreements with customers, it clearly states that, you know, they're responsible for any debit balances or margin accounts that they have with the firm.

It says here on my trading authorization, which clients sign, it says, "The undersigned hereby agrees to indemnify and hold you harmless from and to pay you promptly on demand any and all losses arising thereof or debit balance due hereon."

In other words, every customer that opens a margin account or has any debt with a brokerage firm owes them that money. All right.

MS. CHAITMAN: Okay. Can I just mark -- okay. I'm going to mark as Exhibit 12 -- can I take that? Is that one document, the one you just read from?

THE WITNESS: Yeah.

MS. CHAITMAN: Okay. So I'm marking as

Exhibit 12 -- this is a trading authorization.

THE WITNESS: Here, what -- use this one, because this one is -- this copy is better. It's the same type of thing.

MS. CHAITMAN: Okay. So I'm -- you know what? Can I mark them both? Because you read this one. So --

THE WITNESS: It's the same -- it says the same thing.

MS. CHAITMAN: Okay. All right. So I'm marking as Exhibit 12 the one you read.

(MADOFF EXHIBIT 12 WAS MARKED FOR IDENTIFICATION.)

MS. CHAITMAN: And I'm going to mark as Exhibit 13 something called, "Trading authorization limited to purchases and sales."

(MADOFF EXHIBIT 13 WAS MARKED FOR IDENTIFICATION.)

BY MS. CHAITMAN:

Q. And can you just read in whatever the language is that you want?

A. Uh-huh. All right. So for some reason, you know, the trustee convinced the GAO -- I don't -- maybe they didn't care that much about it -- that this six -- that this debit balance was not typical at a

brokerage firm or that they weren't. Now --
Q. Wait. I just want to go back to this. I don't want to lose track of it.
MR. SHEEHAN: Sure.
BY MS. CHAITMAN:
Q. You -- you said that this has better language on the points.
A. It doesn't -- it just shows the customer -- every customer agreement always has that customers are responsible for any debit balance --
Q. Okay.
A. -- they owe the brokerage firm.
Q. Okay. Okay.

REDACTED

REDACTED

Q. Okay.
A. All right.
Q. So I want to go back to one other question. When you stopped buying securities on the split-strike customer accounts, and you said you did that for a short period of time, and then you stopped.
A. It wasn't a short period of time. It was

from 1992 to 2008.
Q. Right, but I understood your testimony to be that when you initiated that program you actually were buying.
A. Oh.
Q. Am I correct about that?
A. Yes, but that was prior to that. That was before the hedge funds. That was prior to '92.
Q. Oh, okay. Okay. Okay. I'm glad you clarified that.
So what -- what were you doing with the money? Let's say that Customer A sent you a million dollars for the split-strike program.
A. It went into --
Q. What --
A. -- treasury bills.
Q. It went into U.S. treasury bills?
A. Well, some of it went into treasury bills. Some of it went back to customers when they withdrew profits --
Q. Okay.
A. -- that didn't exist.
Q. The -- the portion that went into treasury bills, were those interest-paying treasury bills?
A. Yeah.

Q. And do you remember in 1992 what the interest rate was -- was on the treasury bills?
A. Probably like two percent, something like that, on -- you know, one and a half, two percent.
Q. Okay. And is it fair to say that for the whole period up until 2008 that the money that wasn't used to redeem customer accounts was in treasury bills?
A. Probably, yeah.
Q. And that would have been interest-earning treasury bills?
A. Yeah.
Q. Whatever the current interest rate was; is that right?
A. Uh-huh, uh-huh.
Q. Were these longer-term treasury bills --
A. No.
Q. -- or shorter term?
A. No. They were short term. They were T-bills, you know. You know, the short term. One to two years.
Q. Okay. So the customers' money was earning some percentage?
A. Yeah.
Q. Whatever the treasury bill rate was?

A. Yeah, but there wasn't enough treasury bills to cover all of the liabilities.

MS. CHAITMAN: Okay. Does everybody -- do you want to take a break, and then we'll go through until --

MR. SHEEHAN: Sure. As a --

MS. CHAITMAN: Because I'm about to -- to go through the Dubinsky report, which is going to be tedious. Why don't we take --

MR. SHEEHAN: Whatever.

MS. CHAITMAN: -- five minutes.

MR. SHEEHAN: Five minutes?

MS. CHAITMAN: Yeah.

MR. SHEEHAN: That's good.

THE VIDEOGRAPHER: Going off the record. The time is 13:01.

(RECESS FROM 1:01 P.M. TO 1:18 P.M.)

(MADOFF EXHIBIT 14 WAS MARKED FOR IDENTIFICATION.)

THE VIDEOGRAPHER: Back on the record. This begins media number three in the deposition of Bernard L. Madoff. The time is 13:18.

BY MS. CHAITMAN:

Q. Mr. Madoff, I've just given you what had previously been marked in your -- in a -- your

deposition in June, but I've renumbered it as Madoff Exhibit 14.
This is a statement for one of my clients, Arthur Blecker. It's dated June 30th, 1986. And what is the trading strategy on this statement?
A. It looks like a convertible bond, buying convertible bonds and selling the -- the related stock.
Q. Okay. And where it says long --
A. Uh-huh.
Q. On this statement, which was sent to the customer, long means that the customer owns it; right?
A. Correct.
Q. Whereas, on the confirmation, the actual trade confirmation, it would be the opposite; right? It would show --
A. That -- that Madoff sold it to the customer. "We sold," it would say.
Q. It would say the firm --
A. The firm sold it to the customer.
Q. -- sold to the customer.
Okay. And, conversely, where it says, "Short, Interco, Inc." --
A. It would show we bought from the customer.
Q. Okay. And am I correct that your testimony

is that all of the long positions reflected on the arbitrage strategy statements were actual positions that you held?

A. That's correct.

Q. Okay. So, if you can, I want you to take a look in the Dubinsky report, which we've marked as Exhibit --

MS. CHAITMAN: What did we mark it as?

MS. FEIN: 7.

MS. CHAITMAN: Dubinsky --

MS. FEIN: 7.

MR. SHEEHAN: 7.

BY MS. CHAITMAN:

Q. 7. As Exhibit 7. If you could, look at page 16.

A. Okay.

Q. In paragraph 35, this is the beginning of Dubinsky's factual background, and it says, "BLMIS." "In 1960 Madoff founded BLMIS as a sole proprietorship. BLMIS" --

MS. CHAITMAN: Page 16.

MR. GOLDMAN: Okay.

BY MS. CHAITMAN:

Q. -- "a market-making business in over-the-counter stocks was registered as a

broker-dealer with the Securities and Exchange Commission as of January 19th, 1960 and operated three business units."

"One, a market-making business, two, a proprietary trading business, and then," parentheses, "together with the market-making business, known inside BLMIS as House Five," end paren, "and, three, an investment advisory business," paren, "known inside BLMIS as House 17."

A. Right.

Q. Now, did people at your firm use the phrase House 17?

A. In the firm?

Q. Yes.

A. Yes.

Q. And during what period of time? From 1960 on?

A. No. Because the 17th floor wasn't in existence in 1960. It only came into existence, you know, in the '80s. It was -- House 17 just refers to -- that was the business that operated out of the 17th floor.

Q. Okay. But -- and that was the business that was --

A. The IA business. It was basically just

split-strike business, because that was -- that did -- I think the 17th floor came into existence after 19 -- in -- after '92.

Q. Right. So isn't -- isn't it a fact that when you -- when you started doing the -- we'll call it, the fraudulent investment advisory business, that you moved the people who did that down to a separate floor?

A. That's correct.

Q. And was your idea to separate them from everyone else, so that there wouldn't be --

A. Well, what happened was when we closed the Avellino & Bienes' accounts in '92, the -- when we -- when -- I decided to take the -- those clients back directly into the account.

So the -- in other words, after I -- I returned the money to Avellino & Bienes' accounts, there was an uproar from those accounts, as well as my father-in-law, because they were all basically -- most of them were -- were his accounting clients, and they -- you know, they all wanted to continue to do business.

The SEC had told me at the time, they said, look, you -- you want to -- you want to still do business with these people. That's fine, because

there's nothing wrong with you doing business with these people.

As a matter of fact, they said, if you want to do business with the Avellino & Bienes' people, that's -- that's fine too. They just have to register as an -- as a registered investment company, you know.

I said, no. I said, I'm -- I was furious with -- with them at the time, because they had never told me that they had changed their mode of operation, where they were now paying them, you know, interest on -- on a loan.

That was not something that was ever agreed upon with me. So I said, I'm -- you know, I decided I'm sending the money back, closing those accounts, but, of course, I started getting, you know, a lot of pressure from these people, who were relying upon that money, you know, to live on, you know.

They said, no. Why -- why can't we open a direct account with you, you know? I said, well, because I'm not really equipped to handle all of these individual accounts, you know. I -- they had like 500 customers, you know, clients, you know.

So I said, look, you know, I don't want to do that. But then it was Frank DiPascali basically who said -- because he was, you know, handling that

stuff at the time. He said to me, look, let's -- you know, let's take these -- these new clients.

And I said, well, you know, it's like, you know -- it's -- who the hell is going to handle all of that stuff? And he was the one that said, well, you know, we'll just computerize the trading, and, you know, I -- I can handle all of that stuff.

So I operated -- I said, all right. You want to start doing that, we'll -- we'll start doing that. And that's when I -- I needed more space and operated and put them on the 17th floor.

Q. Okay. So House 17 was only a term used after 1992?

A. Pretty much. It's -- to my recollection, yes.

Q. Okay.

A. Because it didn't exist, the 17th floor --

Q. Okay.

A. -- before then.

Q. Okay. And is it fair to say that it was only after House 17 was formed, by that is you moved people downstairs, that it was only after that that you first began the investment advisory fraud?

A. Correct.

MR. SHEEHAN: Objection. Go ahead.

BY MS. CHAITMAN:
Q. Let me ask that in a way that Mr. Sheehan won't object.
Was there any investment advisory fraud done by your firm prior to the formation of House 17?
A. No. I mean, I'm not exactly sure how you're using House 17, like in what reference, you know.
Q. Well, the -- when you moved people down to the 17th floor --
A. Uh-huh.
Q. -- it was Frank DiPascali, Jodi Crupi, Annette Bongiorno?
A. Yes. And then the -- the whole -- the mailroom was down there and the -- you know, part of the computer operation was down there. Anything that -- anybody that was going to be related to all of these accounts basically.
Q. Okay. And -- but that was -- that was done sometime in 1992 --
A. Right.
Q. -- or '93?
Well, do you remember when?
A. No. I don't remember. It was like -- I -- you know, I'd have to look at the leases, but basically it was -- it all started basically after

the -- I know it was '92, because that was when the Avellino & Bienes thing blew up.

Q. Okay. Okay.

A. It was the summer of '92, was when the Avellino & Bienes started. So it would have to be sometime after that.

Q. Okay. Now, during the period prior to 1992 was the investment advisory operation handled separately from the market-making and proprietary trading?

A. Yes. Yeah, it always was.

Q. It was always handled separately?

A. (WITNESS NODS HEAD UP AND DOWN.)

Q. But --

MR. SHEEHAN: The witness nodded yes.

THE WITNESS: Huh?

MR. SHEEHAN: You nodded yes.

MR. GOLDMAN: You have to verbalize your answer.

THE WITNESS: Oh.

MR. GOLDMAN: You seemed to indicate while you're nodding your head.

THE WITNESS: Yes.

MR. SHEEHAN: Thank you.

BY MS. CHAITMAN:

Q. During the 1980s who was responsible for the investment advisory accounts, like we just looked at the -- the Blecker statement, June 30th?

A. Me.

Q. You handled that?

A. Right.

Q. Okay. Did you have traders who were in the market-making or proprietary trading groups that actually did the trading for the investment advisory customers in the '80s?

A. No. The only one that handled the -- that spoke to the clients and that made the decision of what to buy and sell for the clients was myself.

Q. Okay.

A. Not -- none of the market-makers. I mean, market-makers might have bought stock into the firm's -- into the firm's inventory, but I was the one that actually made the decision as to put the -- put the trade through to a client account.

Q. Okay. And since you were buying from inventory, you could just look at the inventory and decide what --

A. Yeah.

Q. -- to sell to the --

A. Or if I went out and -- you know, or if it

went -- or if the market-maker bought it from the street into -- into his account, and then I would make the decision --
Q. Okay.
A. -- to put it into a client account.
Q. Okay. If you'd be good enough to look at paragraph 119 of Dubinsky's report.
MR. GOLDMAN: One -- one --
MS. CHAITMAN: It's paragraph 119.
MR. SHEEHAN: Paragraph 119. Okay.
THE WITNESS: Where the hell is paragraph 119?
MS. CHAITMAN: The --
MR. GOLDMAN: Page 51.
THE WITNESS: What page?
MR. GOLDMAN: 51.
THE WITNESS: Okay. Uh-huh.
BY MS. CHAITMAN:
Q. If you could, just read paragraphs 185 through 190. I just want to ask you some questions about --
A. Paragraph one --
Q. 185.
MR. SHEEHAN: Okay. So we're --
MS. CHAITMAN: You know what? Oh,

we're looking at different --
THE WITNESS: I'm not with you.
MS. CHAITMAN: You know what? I've got different versions of the Dubinsky report. Let -- let me do it differently. Hold on one second.
BY MS. CHAITMAN:
Q. Okay. If you'd be good enough to turn to page 35. So Mr. Dubinsky's -- the heading on subparagraph two is that, "Purported convertible security trades exceeded the entire reported market volume for certain days."
A. Uh-huh.
Q. Do you see that heading?
A. Right.
Q. Okay. And then he explains that he looked at reported records on the New York Stock Exchange, the daily stock price record, the --
A. Uh-huh.
Q. -- American Stock Exchange and the daily price record from the New York Stock Exchange; do you see that?
A. Right.
Q. And he reached the conclusion that these had to be fraudulent trades, because there weren't that

many trades done on those days?
A. Right.
Q. And I believe you've already explained, but can you just explain again why this conclusion is not correct?
A. Well, he's -- he's making -- he's referencing in his footnote that the data was collected from the daily stock price record from the New York Stock Exchange, from the daily stock record price and the American Stock Exchange, which provided the month and short position of the data.
These trades were not executed. There's no relevance to looking at the New York Stock Exchange or the American Stock Exchange, because they wouldn't be -- stock would never have been transacted on those -- on those exchanges anyhow.
Q. Okay. And is that a fact that's generally known or -- I mean --
A. Well --
Q. If you --
MR. SHEEHAN: Object to the form.
THE WITNESS: Anybody that knew Madoff's business -- I mean, anybody, including the clients, it would be hard -- I mean, we were relatively famous for, you know, trading off the

floor of the exchanges.

So, I mean, with -- anybody that was a client of ours or that was a regulator or that was in the industry would know that our business was not transacted on the floor of the New York Stock Exchange.

BY MS. CHAITMAN:

Q. Okay. Now, looking at page 36.

A. Uh-huh.

Q. Dubinsky has a chart showing that most of the trades that -- you know, 41 percent, there were no trades occurred in the market that -- that exceeded one to two times the number of trades on the account statements.

Is that again because he's not looking at the right place, he doesn't have the records to show the trades?

MR. SHEEHAN: Object.

THE WITNESS: Yes.

BY MS. CHAITMAN:

Q. Okay. Now, on page 37 Mr. Dubinsky is saying that the transactions reported on the Avellino & Bienes' statements were -- were not possible because of the volume in the market.

Did you make up the trades for the

Avellino & Bienes' clients, or were those actual trades?

A. You talk -- what period of time are you talking about?

Q. Well, the Avellino & Bienes' clients during the 1980s on the convertible --

A. Right.

Q. -- arbitrage, were those actual trades or were those made-up trades?

A. Those were actual trades.

Q. Okay. If you look on page 38.

A. Uh-huh. All right.

Q. Mr. Dubinsky opines that the -- the purchase prices of the convertible securities did not represent market prices?

A. Right.

Q. I think you've spoken to this, but can you just briefly summarize your position on this.

A. He's -- he -- he's -- he's referencing the New York Stock Exchange bonds, and none of these trades would have -- you know, were executed on the New York Stock Exchange.

Q. Okay. Would it be possible for someone to actually check the prices? Are there records that exist or that even existed as of 2008 which would have

shown what the trade prices were on the over-the-counter market in the 1980s?
A. Would there be --
Q. Is there anyplace that one could have looked for that?
A. On a -- if it was a convertible bond?
Q. Yes.
A. Probably not, because -- well, certainly you wouldn't reference the New York Stock Exchange. The trade didn't take place on that. As to -- there were --
It depends upon -- I'm not sure when -- when there was any records kept as to over-the-counter bond transactions. That was always sort of a sketchy area.
There was confusion in the industry whether bonds that trades -- the bonds that were traded over the counter were reported or not reported. The -- I'm not sure about what date that was.
And, then again, it depended upon how they were reported, because if the bonds were done after hours, they wouldn't be reported to any facility.
Sometimes you would have to call up the -- for awhile the NASD put a system in where you would call them up and report them over the phone, you know, after the close of the day, but there was always sort

of confusion about that.

Q. Did the trustee or any attorney working for the trustee ever ask you whether you purchased the convertible bonds --

A. Not to my recollection.

Q. -- through the New York Stock Exchange?

A. No.

Q. Did they ever ask you anything about how you acquired the bonds?

A. I don't think so.

Q. Did they ever talk to you about how the bonds were priced?

A. No.

Q. Now, on page 40 Mr. Dubinsky states at the top of the page that, "Convertible securities were purportedly traded by the IA business even after they were called for conversion."

A. Correct.

Q. Do you have any comment on that conclusion?

A. No, because, you know, I don't -- I don't remember this particular trade. You know, I wouldn't have -- it was so long ago that I wouldn't have record.

And, again, I'm not sure that you -- I'm not sure of whether or not you are able to trade a bond

after the fact that it was converted, called for conversion. I mean, you weren't forced to convert, to my knowledge.

Q. Okay. Well, he only gives one example, and it's McMillan. And he writes in paragraph 100, "The IA business purportedly closed out its position on March 14th, 1985. However, this" -- "the subordinated debentures were converted into 1.6 million shares of common stock in January 1985."

A. He said it was -- it was -- it was -- what? It was converted -- it was --

Q. Look at paragraph 100.

A. Uh-huh. Is he saying they were called or converted?

Q. He's saying that the subordinated debentures were converted.

A. Oh, he's saying called, I think. He said they were -- they were called. Right. He -- he -- what he's pointing out to is these bonds were -- were called, but it was closed out on the customer account in March.

Now, that, to me, looks like that this bond was -- was -- was unwound or swapped, and it may have not been closed out. And the customer -- looking at the customer account, it just says, "Received and

delivered."

It doesn't say converted, which -- which is the way it would always appear, because when we were -- it means that we were unwinding the customer position from -- into the firm's trading account. It was an internalized trade.

So, as far as -- you know, they may have called the bonds, you know, then, but he was -- but he was basically pointing out that we would have had to physically convert it, you know, transfers, if, in fact -- you know, obviously, you couldn't physically convert it after the bond was called, because --

Q. Right.

A. -- they wouldn't do that.

Q. Right.

A. So that -- that points out to me that that was a trade that was unwound internally. That we were just closing out the trade and the customer account transaction.

Q. Okay.

A. It wasn't a bond that was issued to me. You know, it wasn't -- wasn't turned into the company itself.

Q. Okay.

A. Like a conversion.

Q. Okay. In the heading above paragraph 101, he wrote, "The IA business did not account for dividend payments or accrued interest on the convertible securities."
A. Uh-huh.
Q. "Thereby evidencing the fictitious" -- "fictitious nature of the underlying transactions."
A. It depends upon whether the bond -- you know, there are instances where a bond is -- is bought, you know, what they call traded flat. It means traded without -- without interest.
It's like that with dividends also. You can trade a stock flat X dividend. You buy it at a lower price, because you're buying it without the dividend.
It's -- it's a transaction that you would -- you know, typically it would be done between dealers and professionals, not for the average customer, because these -- these instruments are bought to trade.
They're not interested -- they're not bought as an investment purpose to be held, which is the way -- you know, which is -- if you were doing that as typically an investment type of account, then, obviously, you would want to, you know, get the dividend for income and so on and so forth.

But professionals will trade what they call flat -- or just like you could buy a zero coupon bond. Most customers don't buy zero coupon bonds, but -- but dealers, traders, like ourselves, typically will trade, you know -- you know, zero coupon bonds are flat, because what you're really doing is you're not --

The idea of the trade is not to cash the dividend or the interest, but basically to use the instrument as a trading vehicle, but you -- when you do that, obviously, you account for the dividend in the price of the stock.

So you're -- you adjust the price of the stock to the client based upon the fact that you're not getting a dividend.

Q. So --

A. And, also, one of the things Dubinsky doesn't seem to account for is that brokerage firms trade what they call due bills.

In other words, most -- when you buy stock frequently, you're not getting the -- the dividend from the company, because you're buying the stock -- it's coming -- it's being transacted in what's known as street name, which is -- it's not in -- registered in -- in the client's name and so on.

So you -- a lot of times -- very frequently you'll buy stock from a customer that pays a dividend or declared a dividend, and you won't get the dividend. The company is going to pay the dividend to whoever the stock's name is registered in.

And most stocks are not registered in clients' names anymore. They're -- they're registered in a street name. So the brokerage firms will issue due bills to each other to get the monies, and then you just journal it into a client account.

He doesn't go into any of that, which is -- I can understand, you know. I'm not faulting him for that. It's not that the customer didn't -- didn't get the price.

So our customer -- if they weren't getting the dividend, they were -- they were getting a lower price on the stock, you know, to account for that, because the firm is going to get the dividend.

So you have to make the customer whole some way. When you're internalizing trades as principal, that's a common way of doing business.

Q. Did Mr. Dubinsky ever talk to you?

A. No. I never knew he existed until I saw the report.

Q. Okay. Did anyone from the trustee's side,

any expert, ever question you about any of the --
A. To my recollection --
Q. Let me just finish the question.
-- any of the convertible arbitrage trade?
A. No. I never had any conversation with the trustees regarding any of this trading, other than when they came down here to speak to me, but I don't think they ever really got into -- into the trading.
Q. Okay. Mr. Dubinsky reaches the conclusion on page 41, just above paragraph 105, that there's no evidence that the IA business converted the convertible securities into common shares; do you see that?
A. Yeah.
Q. And then he says, "Companies that have publicly-traded securities typically use third-party institutions, known as transfer agents, to keep track of the individuals and entities that own their stocks and bonds."
"Most transfer agents are banks or trust companies. Although, companies sometimes act as its own transfer agent. The transfer agent maintains records of the shareholder information."
And then in paragraph 109, he says, "In order to have converted preferred convertible stock

and convertible debt into common stock, the IA business would have needed documentation regarding the conversion of the securities."

A. Uh-huh.

Q. Now, did you have that documentation, or did you --

A. No. As I stated earlier, if -- if we converted -- when we converted stock, we typically would have one of our clearing facilities convert the stock.

Meaning, Commercial Bank of North America, Bankers Trust, Irving, any one of those people. Marine Midland that -- that provided that facility for us.

So we would not, except under rare occasions, physically convert the stock ourselves. Doesn't mean the stock wasn't converted.

Q. Okay.

A. And, as far as him relating to the transfer agents, the stock trades in street name. So -- meaning it's -- it's traded as a negotiable instrument. It's not -- it's very rarely put in a customer's name, unless the customer is going to request delivery of the securities.

So if a customer wants to hold the

securities themselves, which now doesn't exist -- as a matter of fact, they're eventually going to -- that's never going to happen, because nobody wants to go through transfer agents.

So I don't even know why that's in the report, because very few brokerage firms put stock in a customer's name. Customers don't want to hold it.

If the brokerage firm is holding their security, they always -- they never hold it in a customer's name. They hold it in -- in the street name. And the dividends don't -- do not go to the customer directly from the -- from the company --

Q. Right.

A. -- transfers. They get paid to the broker, and then the broker would make the customer whole.

Q. And that would have been true for the 1980s?

A. Yes.

Q. Okay. Now, in paragraph 115 Dubinsky wrote, "Trade confirmations fabricated by the IA business to support the convertible arbitrage trades were actually prepared backwards, as though BLMIS was trading as a principal, rather than an agent."

A. Oh, that's true. I mean, we always trade as principal, as I said before. Doesn't mean they were created backwards.

Q. Right.
A. I mean, it says right on the customer confirmation that we're trading as principal.
Q. Right.
A. And that's not -- that has nothing to do with whether you're trading it backwards or not.
Q. Right.
A. He's almost insinuating that -- from that statement that trading as a principal, there was something wrong with it. That would be great news to the industry.
Q. I want to just interject some questions on another subject. Can you describe for us what kinds of trading you did with Bear Stearns?
A. Mostly market-making, proprietary trading or for Bear Stearns' customers. There's -- our trades with Bear Stearns were typical of what we traded with everybody.
It was -- we were trading basically for Bear Stearns' own account or for their customers' accounts. If Bear Stearns got -- wanted to buy and sell stock for -- for one of their clients, they had to go to a market-maker, like myself, unless Bear Stearns traded the stock himself. Then he would internalize the stock himself, just as I'm doing.

Q. Okay. So Bear -- but Bear Stearns was a market-maker; right?
A. Some -- in some of the securities. Yeah.
Q. Okay. And they were doing convertible bond trades in the 1980s?
A. Yes.
Q. Okay. So why would they need you?
A. Well, because they may have not been making a market in the convertible bond that we were making the market in. In other words, they -- you know, there are times when we were a market-maker in a convertible bond, and we bought it from somebody else as well.
If -- if we didn't -- if we didn't have the stock in inventory, and we didn't want to short it to a client, we might go to Bear Stearns, and they might do the same thing to us.
But Bear Stearns was a competitor at times, and they were not a competitor, you know, at times. But Bear Stearns was -- was one of our big clients.
Q. Did they buy securities for you and hold -- and hold those securities?
A. Did Bear Stearns? We had accounts at Bear Stearns. Yes.
Q. So there would have been times when you

purchased securities through them, and they would hold those securities?
A. Bear Stearns?
Q. Yeah.
A. Probably not. You know, usually they would, you know -- it depends upon what -- what kind of stock it was and whether it was a stock that went through the clearinghouse or not.
Q. Or convertible bonds, would they sometimes be holding some of your inventory?
A. No. They wouldn't typically be holding convertible bonds for us.
Q. Would you be holding convertible bonds for them?
A. Probably not.
Q. Okay. I'd -- I'd like to look at pages 48 and 49 of the report.
A. Uh-huh.
Q. This is -- in paragraph 117, if you can just read it to yourself, and then I'll ask you some questions.
A. This -- this was an example that I pointed to earlier where he fails to understand he's reading the confirmations wrong. He's reversing -- he's confusing the we -- we to -- to you.

Q. Okay. Okay. And he's -- he's concluding that this is -- this is evidence of your fraud; right?
A. Yeah. He's -- right. I mean, it's -- clearly he's -- he's not understanding that when we say, "We bought," it's we bought from the customer or we sold to the customer.
Not as he's -- so he's saying that if we -- if we wrote the confirmation wrong, the trade never could have taken place, because he's -- he's not reading it properly.
Q. Right. Can you describe for us the kinds of transactions you did for Carl Shapiro's various accounts that you felt uncomfortable about doing?
MR. SHEEHAN: Object.
THE WITNESS: Okay. Well, I -- it would be easier for me to explain the strategies that I initiated for the big four accounts, which Carl Shapiro would be included in that.
The -- we have to go back to -- this is going to take a little bit of time. How much time do we have?
MR. SHEEHAN: The rest of the afternoon.
THE WITNESS: Oh, okay. That's fine with me. Unfortunately, I have nowhere to go.

MS. CHAITMAN: Yeah. Do you -- are you getting tired?

THE WITNESS: No. I'm -- I'm fine.

MS. CHAITMAN: Are you getting tired?

MR. SHEEHAN: No.

MS. CHAITMAN: Okay. Everybody is okay?

MR. SHEEHAN: I haven't fallen asleep once.

MS. CHAITMAN: You're okay?

THE WITNESS: I'm okay.

MS. CHAITMAN: You're okay? Everybody is okay?

MR. SHEEHAN: Yeah. We --

MS. CHAITMAN: You're getting tired?

MR. SHEEHAN: We can go for a little while longer. I'm okay.

THE WITNESS: Yeah, I have nowhere to go. So --

MR. SHEEHAN: Sure. That's true, but it's your call. It's your dep.

THE WITNESS: No. I'm all right.

MS. CHAITMAN: Is everybody else okay?

MR. SHEEHAN: Sure.

THE WITNESS: Okay.

MS. CHAITMAN: Why don't we -- why don't we say we'll go to 2:30 and evaluate how everybody is?

MR. SHEEHAN: That's fine.

MS. CHAITMAN: Okay. Good. Okay.

THE WITNESS: All right. This goes back to the -- the Madoff misery. All right. In 1980 I was approached by some foreign clients, basically French clients, institutional clients, to -- for those of you that are old enough to remember this -- that excludes you.

MS. CHAITMAN: Amanda, we're excluding you.

THE WITNESS: That excludes you.

In 1980 Mitterrand came in to be -- to be president of the premier of France, and basically was a socialist, but, you know, also being accused of being communist, and decided to nationalize the banks and the industries in France.

So there was a hysteria in France, because everybody thought that France was going to go down the tubes. At -- and what -- he put into place currency controls, so that French citizens were not allowed to own any currencies,

other than the franc.

So if you were a French citizen, you couldn't own dollars or yen or anything else. You had to own just French francs. You couldn't trade in any currency.

And the French franc was going to be devalued dramatically. So there was hysteria in France to get their assets out of the franc and into dollars.

But the only way that you could do that is you could own U.S. assets, like securities. And in order to do that you would sell the franc and buy dollars to purchase the U.S. security, because U.S. securities had to be settled and paid for in dollars.

So the -- there was an interest in people taking -- selling the French franc, converting the francs into dollars, and then being able to buy U.S. securities, which traded in dollars, and they had to be held in -- in dollars. And that way your -- your -- you now had your currency -- your assets held in dollar-denominated securities.

The -- that was the one loophole that the government allowed French citizens to do, was

to buy U.S. stocks, and to do that you sold the franc on the dollar.

So the -- anybody that was -- that wanted to do that had to find a broker that would buy U.S. securities for them. So I was approached by some large, you know, French citizens that were very wealthy that wanted to do this, that wanted to establish a portfolio of U.S. securities, so that they could get their money out of the French francs and into the dollars.

It was a perfectly legal strategy. It was not anything unique or new, but to do this you, obviously, you know, accomplished what you wanted to do, but you now had your money in dollars, and you ran the risk of the U.S. market, because you owned -- you -- you had your money in U.S. securities.

So because at that time our reputation was as an arbitrage firm, that was -- had some sort of expertise in hedging, I was approached by these French citizens and some Swiss banks to execute this transaction for them.

I did -- did this type of trade, and so did Goldman Sachs and some other arbitrageurs in

Wall Street. Basically it was -- they were all the --

During that time the arbitrage business and convertible bonds or any type of what's known as bona fide arbitrage was controlled by the -- the Jewish arbitrageurs. That was like Goldman Sachs, Bear Stearns, you know, the Gruss & Company. There was a whole -- there was a list of -- of firms.

And I had already been established as a trader in convertible bonds. I was sort of minted by Gus Levy, who is a senior partner of Goldman Sachs, and Cy Lewis from Bear Stearns and so on and so forth.

So what happened was I was approached by these Frenchmen to -- to do this trade for them. However, what they wanted to do was also hedge this portfolio of U.S. stocks that they had.

BY MS. CHAITMAN:

Q. Can you give us the names of the people you're talking about in France?

A. A family known as the Igoins, Albert Igoin, I-g-o-i-n. Jacque, you know, Amseleum was another one. And then there were some other Swiss bankers --

Swiss bankers and French, you know, entities.

Eventually I owned -- I did these trades for people like Christian Dior, the Bettencourts, who owned L'Oreal, and so on and so forth.

So they came to me, and they said, okay. Can you put this portfolio of securities together? And I said, yes, I can put the portfolio of securities to buy for you, but you're going to be involved with the market risk.

So they said, well, how can you hedge that? So I said, well, you can -- you can go short against the box. It's a strategy where you would short the stock. Or you can short similar securities. There's any number of forms -- ways you can hedge it. Using options and so on and so forth.

So they said, okay. That -- that's fine. Go ahead and do that for us. So I started doing that business for them.

It so happens at that same time I was trading -- doing convertible bond arbitrage for, you know, these four families, the Shapiros, Picowers, Levys and the Chaises, where I was doing basically general convertible bond arbitrage for them, which were involved doing -- going long in convertible bonds and short the common stock.

However, the -- the tax rate at that time in the '80s was a very high rate, anyways, at that time. Like an 80 percent tax rate on short-term capital gains.

So I had one group of clients that were doing -- that was doing convertible bond arbitrage, but they were all short-term gains, taxed at the short-term rate.

And then I had these French people that were doing, you know, this currency arbitrage. The U.S. clients, these four big clients, were -- in order to save money on taxes was using silver straddles to convert short-term gains into long-term gains, which is a common strategy that most sophisticated investors were using at that time.

They were using silver straddles. They were doing that through Bear Stearns, through E.F. Hutton, through Merrill Lynch. Those were the firms -- I did not trade in commodities.

So they were doing this -- this trading through these other firms, which was, you know, using these straddles to convert the short-term gains that they had in the -- in the stock market trades with me into long-term gains with them.

But the IRS, the Internal Revenue Service,

was questioning the use of silver straddles for everybody, you know, in the United States. They were saying that there was no risk involved in these trades, and they thought that these trades were -- boarded on being sham transactions.

So they were disallowing the use of silver straddles to -- to offset, you know, short-term gains and convert them into long-term gains. So my -- I had these -- these four families that were using these silver straddles, as I said, through Bear Stearns, E.F. Hutton and Merrill Lynch.

And they wanted to not use these -- those -- that method. And Picower was using leasing shelters. He had a leasing company to offset these gains. So they came to me. They were -- they had been clients of mine starting in the '60s and so on.

And I was generating convertible bond arbitrage trading profits for them for years, where they were making anywhere from 20 percent, 18 percent to 15 percent.

So everybody was very happy and making a lot of money with me, and I was happy doing it, but they now were in a situation where the tax rates were very high. And they came to me and said, look, we can't use the silver straddles to convert your short-term

gains into long-term gains.

You know, what can you do to -- to help us on this thing? I said, well, there's basically nothing I can do, because the tax shelters that you're using I don't recommend. I'm not in the tax shelter business. I'm certainly not -- you can't -- I'm not in the commodities business.

I said, you can't use the commodity trades anymore. The only thing that I know that you can do is to generate long-term gains, rather than short-term gains, but the arbitrage profits that we've been doing for years are all automatically long -- short-term gains.

So you've got to stop -- you've got to stop doing that sort of trading. If -- if you don't want to pay the taxes at the short-term rate, I said, you've got to use another strategy.

So what other -- what other strategy can we use? I said, well, you can -- you can use a -- a portfolio of stocks. You know, hold them for one year. And if the market goes up for one year, you'll have long-term gains and pay the long-term gain rate.

They said, well, that's terrific. I said, yeah, except that you're now subject to market risk, you know. So I said, the market has to go up. I

can't guarantee you the market is going to go up over the next year.

I said, it might. I said -- I happened to be bullish at the time. This was also 1980. I said, I can try and hedge it for you, but, again, there's no guarantee, you know.

So they said, what kind of hedges can you do? I said, you can go short against the box, which really isn't a good strategy to use, because the IRS will challenge that the same way they'll challenge the silver straddles, but you can go short similar securities.

Meaning you can buy IBM and then short Hewlett-Packard or Dell computer, you know, things like that. That's perfectly legal. Perfectly -- it'll stand up tax wise and so on.

But, again, this strategy will only work if the market goes up, and you have to be willing to hold the stock for one year. So they said, okay. Let's try it.

So I said, all right. I said, as it turns out, I have a great situation for you. I said, I have a group of French clients that are hedging their currency trades with -- I'm putting together a portfolio of stocks for them with their long and

short.

I said, you want to do a similar type of strategy, long and short. So now we can have a good liquidity pool, you know. I can put both of your trades together.

I said, that's the good news. The problem is the French people, they want to -- they don't want to unwind or undo their transactions, you know, right away, I said.

So you're going to have to sort of understand they're -- they want to hold it -- you want to hold it for -- your period -- your stock for one year. They don't -- they also want to hold it, but we're going to have to sort of, you know, coordinate this thing, where, you know, we're not going to unwind -- meaning we're not going to sell your portfolios before they want to sell their portfolios and so on.

So there has to be some sort of coordination with this. Now, this is a, you know, perfectly legal situation to do, but, you know, you're making some sort of a commitment that when you want to sell, they're going to want to unwind their -- their transaction together.

All right. Goldman Sachs was doing a

similar type of arrangement, but they were doing it primarily for the firm's, you know, best clients and their own partners. This was a, you know, obviously a very sort of specialized type of transaction.

Q. Let me just interrupt you here. Were you actually purchasing the securities for the French clients?

A. Everybody was buying.

Q. Okay.

A. These were perfectly legitimate.

Q. Okay.

A. Everybody was buying and selling. The big advantage, as I said, was that there was a two big liquidity pools on both sides of the transaction.

In other words, there was -- here you had a group of clients looking to accomplish pretty much the same thing. Although, one -- they were both doing it for tax purposes. Perfectly legal, but -- but different, because of the way the currency -- the way the tax laws were in the different countries.

So everybody said, fine. Go ahead. You know, so we -- I -- we started doing this transaction, and it worked out. It was like a dream. The market from 1980 continued to march upward.

So the four big families had these

portfolios where the stocks went up. They had long-term gains on -- you know, it looked like they were getting long-term gains on their long portfolio, and on the short portfolio that was hedging it, they were having short-term losses.

All right. Which was fine, especially if the long positions went up more than the short positions went up. So you had a -- you know, one could go up 30 percent, and one could go up 20 percent, but you were making the difference of ten percent.

So it worked like a dream. Everybody was happy, including myself. That goes fine from 1980 literally through 1987. And comes 1987, the market crashes, and the -- the four families, particularly really two families, Picower and Shapiro, more than Levy and Chais.

Primarily it was the two of them, but let's say three. Throw Chais in that pool. Decided, listen, the market is crashing. The game is over. Now all of these stocks that went up over the past, you know, years --

And some of them, they literally held these positions open for almost eight years. They -- let's sell out, because the market is going to -- the market

is crashing, and I'm going to go -- continue to go -- continue to go lower. I'm going to lose all of our long-term gain advantage. So I want to get out.

The problem was that this was not a good time for the French people to close out their transactions. So I said, look, let's not everybody panic. The market is -- you know, is going down, clearly, but it's going to recover. Let's not sell out, I said.

And we have commitments. I can't, you know, start liquidating you and -- and then it's going to screw up my relationship with -- and your relationship with the -- with the foreigners. So let's just hold on.

That went fine, but -- you know, for about a day, but then, you know, Shapiro and Picower, everybody -- they got hysterical and said, no, no, no, no. We want to sell out.

So I had no choice, because these commitments that we had made to -- you know, originally were all verbal commitments, and I couldn't literally, you know, tell them, you can't sell, you know. If they wanted to sell, they wanted to sell.

So we started liquidating their portfolios on the long side. And they said, well, wait, you

know. I said, you've got to liquidate the short side also, but -- you know, you can't liquidate one side without the other.

So, to make a long story short, they -- they convinced me to -- to -- you know, to leave the shorts -- to take over their short positions for them. And that way -- because they wanted me -- let's get out of everything.

And I said, no, no, no, because you're going to screw up my relationship with the foreigners. I said, we can't do that. And that was my mistake. I mean, I -- I had no recourse.

I mean, I could have -- could have tried to, you know, sue them, but I had no legal grounds to sue them. So I -- I wound up selling their long positions for them, sending the money they needed to pay their taxes and taking over the short.

They were convinced that the short positions were -- were going to go down also. So that they -- they said, listen, you're -- you're worried about the short positions going up. The market is going to crash.

We're going to -- we'll make money on the long side, selling them out, and the short -- we'll wind up making money on the short side also. I said,

you know, that's not going to happen.

So for awhile they seemed -- they seemed correct. The market, you know, continued to sell off, and we -- you know, you know, they weren't that worried about it.

But then, of course, the market turned around, and they started losing money -- I started losing money on the short positions, because I was --

Oh, by the way, at that time I made -- what happened was in order for them to convince me to do this for them, they said, okay. You take over the short positions, and we'll hold you harmless from any losses you take on it.

You know, they were so convinced that -- that they were right, that the market was never going to recover, they were going to make money on the long side and on the short side, you know, they said, you're going to make money on the short side. Don't worry about it.

Well, the market turned around. The -- they did make their money. They made huge profits on the long side. On the short side I wound up losing money. It was a terribly stupid thing, you know, for me to do. I mean, people that knew me said, how on earth could you do such a thing, you know?

Q. Did you have a written agreement with the --
A. I had --
Q. -- four families --
A. I had --
Q. -- or --
A. Yes. As a matter of fact, Carl Shapiro's attorney was a man -- was one of the senior partners at Coopers & Lybrand, which then became Price Waterhouse, who was also doing this type of trading with me at the time.
And we put together hold harmless agreements that said they would be responsible for any of my losses that I -- that I took.
And, first, they wanted to do everything verbal, said, don't worry, you know, we have these relationships with you. You don't have to worry about it.
And I said, look, you guys are -- Carl Shapiro was -- they were older at this time. You know, they were old guys. He was ready to die, he claimed, at 60. Still going strong at 103, but --
I said, look, put it -- I said, you know -- I said -- he said, don't worry about it. My children will make you whole. They'll respond. So every -- everybody -- their children, by the way, were my age.

So, you know -- and they were friends of mine. So it -- this whole thing was like a whole family type of situation.

But I said, look, you know what? I trust everybody. Let's put it in the trust agreements. So they -- I became the executor of their estates. They sold -- they changed their trust agreements.

As a matter of fact, Norman Levy -- J.P. Morgan was the executor of his estate. And I said, I don't -- you know, I don't trust J.P. Morgan. You make me the executor -- executor of the estate.

So I became the executor of the estate, and they signed agreements with -- they also had -- some of the trust agreements, they guaranteed J.P. Morgan -- J.P. Morgan could only trade through me for their account on some of the trust agreements.

But J.P. Morgan was smart enough to say, okay, well, we want you to hold us harmless from any liability. If Madoff makes dumb investment decisions, we don't want to be responsible as the trustee.

So they -- all of this was done. It was fine. Of course, by -- you know, after a period of time, they probably changed all of their trust agreements, you know, because -- but, in any event, I --

Q. Let me just interrupt.
So you had -- you had agreements with Norman Levy, Carl Shapiro?
A. Right.
Q. With Jeffry Picower?
A. Yes.
Q. And with Stanley Chais?
A. Right.
Q. Okay.
A. The -- of course -- you know, it really sort of doesn't matter, because, you know, I never was -- I -- I really couldn't sue any of these people, because for me to start --
One of my choices was, when I started taking these losses, was to start suing everybody, but that would have been a total disaster. I -- I couldn't start suing people, because it would have -- you know, I never would have gotten paid, you know, on these things.
So, outside of the fact they were starting to trade away from me at these firms, also going short and losing money, and I -- I was concerned that I was ever going to get paid, you know, because Jeffry Picower was saying, well, you know, I don't have the money anymore and so on and so forth.

The -- this -- I then made the decision I had to -- I had to, you know, take on new business, because I was depleting my capital from the losses that I was incurring from -- on these transactions.

And I decided to, you know, start handling hedge funds. I had -- also had put together this -- come up with at the same time this split-strike strategy trade, which I thought was a -- you know, a sensible trading strategy. It was.

And I had been, you know, asked by -- by the immediate world to get into this strategy. The split-strike strategy was a strategy that I sort of developed, because the --

The -- the collar of the split-strike strategy is not a new strategy, but what I decided to do was build a collar strategy out of it. I don't want to bore you with all of the details, but it involved hedging.

And so, not only -- you would buy a portfolio of stocks. You would sell calls against it to take in a profit, but then you would hedge yourself by buying puts on the side.

So it was a strategy that -- that, you know, was very appealing to a lot of people. To do the strategy you had to deal with a dealer, like myself.

Because I was trading in the over-the-counter market, I had -- was now doing all of this business away from the floor of the exchange. So everybody wanted to come in to do business.

My concern was -- I said, okay. This is fine. Now, everybody wants to come in. All of a sudden I can develop this investment advisory business.

The problem that I would have is the type of people that this appealed to were the foreign hedge funds, and that was known as hot money. In other words, foreign hedge funds would do business with you, but as soon as you had one bad quarter or one bad month, they wanted their money back and they wanted to disappear.

So I said, to do this investment strategy, the split-strike strategy, you had to sort of stay the course. You had to sort of agree to keep your money in it, because as soon as -- if you have one bad quarter, you know, it's not going to work.

So these hedge funds said, Bernie, we'll have no money -- giving you money and keeping it with you. You just have to make sure that you're not going to return our money, you know, when you all of a sudden decide you -- you -- you don't want to do this

anymore.

So I made a commitment. I said, fine. You -- you become a client. You send me in the money. I'll agree to not return it to you, you know. In other words, their biggest concern was that I was going to be approached by Goldman and Merrill Lynch and everything else, because at that time those firms wanted me to do it for them, this strategy.

They said, because -- you know, even though they could do it themselves theoretically, they had problems doing this type of business, because it was a conflict of interest for them with their other institutional business.

I know I'm boring you with all of these -- these details --

Q. Can I just interrupt you for just a second?

A. -- but it's a complicated situation.

Q. I just want to -- I just want to understand something.

The '87 crash occurs. You then have to work through with the big four an indemnification, because you're going to assume their short positions?

A. Right.

Q. Are you saying that the losses that you suffered as a result of taking over the short

positions for the big four is what ultimately forced you --
A. Yes.
Q. -- into the split-strike --
A. That's correct.
Q. -- fraud?
A. Yeah.
Q. Okay.
A. Now, again, this is my own doing. In other words, this was not -- you know, no one had a gun to my head. My -- my choice was to not do this. Go after these clients, you know, for the indemnity, but the clients were claiming they didn't have the money to pay me, because they were -- they were losing money being short themselves away from me, you know.
So that was -- you know, believe me, I live with this everyday, you know, for the past eight years, you know, trying to figure out why I was so stupid to do this.
And -- but you had to understand, unless you knew me and you knew my relationship with these people, these were like -- these guys were like fathers, you know, to me or brothers to me that I had made literally billionaires.
All right. And made myself a lot of money

also. And I was like, you know, the golden boy of Wall Street, supposedly, this genius. And for me to acknowledge that I was stupid enough to do this situation with them would have been, you know, the end of my business, the end of my relationship, you know.

I had a -- a firm of, you know, at that time, you know, 200 people that I was responsible for working. It would have been the end of Madoff. The end of the firm, you know.

So I decided, you know, to risk this -- you know, my whole life doing this split-strike transaction. And the -- I took in the money and started to try to do the transaction.

The market, you know, in '90 -- '92, as I started to say, wasn't receptive to it. And I started getting under pressure from the hedge funds to invest the money.

They said, look, you know, you made this commitment to take this money from us. You told us you didn't want us to take it back. You know, we don't want to -- we don't want to make treasury bill interest.

I had put the money in treasuries, making two percent. They were expecting to make ten or 12 percent in the strategy. And they kept on saying to

me, do something, you know.

And I said -- so, I said, you know -- you know, I couldn't do the strategy. I said, well, you know, I'll short the strategy to them. I'll -- I'll put the trades on short.

Again, understand that as a market-maker I frequently traded on the short side of the market. That was my business. That's the risk. If you're a market-maker, you're a risk-taker, and you long trade sometimes. You short stock to customers. You short stock in the street. That's the way you do your business.

And, again, keep in mind that going short is not a bad thing. It's not an illegal thing. It's something that you -- that you do. And there's nothing wrong with doing it, except when you do it the way I did it, you know.

So to me to -- you know, to short the strategy, I'm thinking, okay. I'll short the stock for these -- these clients, and then that'll be a short-term thing. It'll take me, you know, a week, a month or whatever it is.

Eventually I'll work my way out of the -- you know, out of the trades, but, you know, it just kept on building and building. And, you know, what I

thought would take a week or a month, you know, a day, all of a sudden was now, you know, getting to be a year.

The -- the biggest problem was I had taken all of these monies in, and, although, I could have done the strategy, it was -- I didn't have enough volume to do these kinds of trades, because you're talking now hundreds of millions and billions of dollars of trades.

And the strategy itself, the split-strike strategy, was a great strategy. It made a lot of sense. And you have to understand, this strategy was so good, you know, the concept -- and it was so -- it was nothing ingenious, but --

It was a -- a sensible strategy, but in order to do it, you had to be a dealer, a wholesaler, like me. You had to be a market-maker, like I was. I was sort of in a unique position to do that. And I had a reputation of building this -- a tremendous concept in -- in this business.

The strategy was so good, if you ever looked at my client base of who I had as clients. It wasn't just some stupid people. Henry Kaufman, who was the chief economist of -- of Salomon Brothers, who moved markets, was a client.

Almost every senior partner from Goldman Sachs, Morgan Stanley, Bear Stearns, Merrill Lynch were all clients of mine in the -- in the strategy.

So -- as a matter of fact, when the trustee came down to meet with me that day, when you were there, and they asked me who knew that this strategy, you know, wasn't -- that you weren't doing the strategy? Who knew this didn't make sense?

I said, look, do yourself a favor. Do not go under the assumption that this was a -- such a stupid strategy that, you know, everybody should have known that you were committing a fraud, because that was -- that was your concept.

What -- not you, David. Irving Picard's concept was this -- this whole strategy didn't make any sense. And why didn't it make any sense? Because one of the world's great idiots, Harry Markopolos, the whistleblower, he --

He was convinced that this strategy was so stupid and so dumb and that Madoff never could have done it. So he kept on going down to the SEC and telling them, Madoff is committing a fraud and this strategy makes no sense. I've been studying this strategy. He can't possibly make these -- these trades or make this credit.

Okay. Now, he was correct, in that, you know, this -- you know, I couldn't have been doing these trades, but the reason I couldn't do them is because I couldn't possibly put that much money to work at that time, because -- you know, he had no idea how much money -- nobody had how much money I had working through them.

All right. So when he went down to the SEC, and he said, Madoff is -- is a fraud -- is a fraud, the SEC kept on looking at all of the -- the strategy, and they said, this strategy -- there's nothing wrong with this strategy.

And they kept on asking everybody on Wall Street, can Madoff do these trades? And they said, of course, Madoff can do these. He's the one -- one of the only ones that can do these trades.

He has all the -- all of his business, so on and so -- so the SEC, you know, told him, you're -- you're nuts. It turns out -- he turned out to be right, but for the wrong reasons. And everything that -- that he told the SEC didn't make any sense.

All right. In any event, I said to the trustee at the time, you're never going to -- you're never going to win a case that says that these people should have known this strategy was a fraud to begin

with, because too many smart people had the ability to get the confirmations, look at the trades, analyze the trades, would tell you that these trades could take place. There was nothing wrong with the strategy. And that was the case.

All right. To make a long story short, the --

Q. It's too late for that.

A. Exactly. Exactly.

That was the disaster.

All right. So what was your -- the finalizing of your question with regard to this? I knew this was going to happen. It happens all of the time.

MR. SHEEHAN: If you want to ask a question, go right ahead.

MS. CHAITMAN: You know what? I think -- I think that we've done enough for today.

MR. SHEEHAN: Sure.

MS. CHAITMAN: I think we're all tired.

MR. SHEEHAN: Yeah, I think so. And I think it -- I just want to put on the record that, obviously, we're not finished with Mr. Madoff, and I haven't had a chance to ask any

questions.

And you've given me a few thoughts here today about some questions I'd like to ask you. So I just want to preserve my right --

MS. CHAITMAN: No. Absolutely.

MR. SHEEHAN: -- to take time with Mr. Madoff. And it may be the next day or the day after that, whatever may be the case.

MS. CHAITMAN: Yeah. I mean, I -- I --

MR. SHEEHAN: We'll -- we'll be back.

MS. CHAITMAN: Yeah, and I haven't finished. We really appreciate your patience and giving us all of this information.

You and I will talk about how to deal with --

MR. SHEEHAN: Yes.

MS. CHAITMAN: -- this?

MR. SHEEHAN: Yeah, yeah.

MS. CHAITMAN: Okay. And we can go off the record.

THE VIDEOGRAPHER: This ends media number three in the deposition of Bernard L. Madoff. Going off the record. The time is 14:36.

(SIGNATURE RESERVED.)

(DEPOSITION CONCLUDED AT 2:36 P.M.)

C E R T I F I C A T E

I, BERNARD L. MADOFF, do hereby certify that I have read and understand the foregoing transcript and believe it to be a true, accurate and complete transcript of my testimony, subject to the attached list of changes, if any.

____

BERNARD L. MADOFF

This deposition was signed in my presence by ____________________________, on the _________ day of _________________________, 2017.

____

Notary Public

My commission expires: _________________

E R R A T A S H E E T

RE: SIPC VS. MADOFF

DEPOSITION OF: BERNARD L. MADOFF

Please read this original deposition with care, and if you find any corrections or changes you wish made, list them by page and line number below. DO NOT WRITE IN THE DEPOSITION ITSELF. Return the deposition to this office after it is signed. We would appreciate your prompt attention to this matter.

To assist you in making any such corrections, please use the form below. If supplemental or additional pages are necessary, please furnish same and attach them to this errata sheet.

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STATE OF NORTH CAROLINA
COUNTY OF PERSON

CERTIFICATE OF TRANSCRIPT

I, Lisa A. DeGroat, a Court Reporter and Notary Public in and for the aforesaid county and state, do hereby certify that the foregoing deposition of BERNARD L. MADOFF, was taken by me and reduced to typewriting under my direction; and the transcript is a true record of the testimony given by the witness.

I further certify that I am neither attorney or counsel for, nor related to or employed by any attorney or counsel employed by the parties hereto or financially interested in the action.

This the 3rd day of January, 2017.

Lisa A. DeGroat

LISA A. DeGROAT
Registered Professional Reporter
Notary Public #19952760001
Expiration Date: December 8, 2020
1-888-656-DEPO

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Federal Rules of Civil Procedure

Rule 30

(e) Review By the Witness; Changes.

(1) Review; Statement of Changes. On request by the deponent or a party before the deposition is completed, the deponent must be allowed 30 days after being notified by the officer that the transcript or recording is available in which:

(A) to review the transcript or recording; and

(B) if there are changes in form or substance, to sign a statement listing the changes and the reasons for making them.

(2) Changes Indicated in the Officer's Certificate. The officer must note in the certificate prescribed by Rule 30(f)(1) whether a review was requested and, if so, must attach any changes the deponent makes during the 30-day period.

VERITEXT LEGAL SOLUTIONS
COMPANY CERTIFICATE AND DISCLOSURE STATEMENT

Veritext Legal Solutions represents that the foregoing transcript is a true, correct and complete transcript of the colloquies, questions and answers as submitted by the court reporter. Veritext Legal Solutions further represents that the attached exhibits, if any, are true, correct and complete documents as submitted by the court reporter and/or attorneys in relation to this deposition and that the documents were processed in accordance with our litigation support and production standards.

Veritext Legal Solutions is committed to maintaining the confidentiality of client and witness information, in accordance with the regulations promulgated under the Health Insurance Portability and Accountability Act (HIPAA), as amended with respect to protected health information and the Gramm-Leach-Bliley Act, as amended, with respect to Personally Identifiable Information (PII). Physical transcripts and exhibits are managed under strict facility and personnel access controls. Electronic files of documents are stored in encrypted form and are transmitted in an encrypted fashion to authenticated parties who are permitted to access the material. Our data is hosted in a Tier 4 SSAE 16 certified facility.

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Inquiries about Veritext Legal Solutions' confidentiality and security policies and practices should be directed to Veritext's Client Services Associates indicated on the cover of this document or at www.veritext.com.